No. 722

TRANSCRIPT OF RECORD

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United States Court Of Appeals

TENTH CIRCUIT

No. 5500

UNITED STATES OF AMERICA,
Appellant,

vs.

VICTOR H. and ELSIE AKIN, FRED C. and ALICE M. KLUVER, E. F. and GLADYS MUNROE,
Appellees.

Appeal from the United States District Court for the District of Colorado

Filed October 25, 1956

United States Court Of Appeals

TENTH CIRCUIT

No. 5500

UNITED STATES OF AMERICA,
Appellant,

vs.

VICTOR H. and ELSIE AKIN, FRED C. and ALICE M. KLUVER, E. F. and GLADYS MUNROE,
Appellees.

Appeal from the United States District Court for the District of Colorado

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IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 5500

UNITED STATES OF AMERICA,
Appellant,

vs.

VICTOR H. and ELSIE AKIN, FRED J. and ALICE C. KLUVER, G. F. and GLADYS MUNROE,
Appellees.

Statement of Points Upon Which
The Appellant Intends to Rely.

On appeal of this action to the United States Court of Appeals for the Tenth Circuit the appellant intends to rely on the following points:

1. The District Court erred in refusing to grant the defendant's motion for summary judgment.

2. The District Court erred in holding that the portions of assessments of mutual ditch companies, which were levied or used for capital purposes, were deductible expenses under Section 23 of the Internal Revenue Code of 1939 to the farmers paying the assessments.

Donald E. Kelley,
United States Attorney.

Filed October 26, 1956.

United States vs. Victor H. And Elsie Akin, et al.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Pleas and Proceedings before the Honorable Jean S. Breitenstein, Judge of the United States District Court for the District of Colorado presiding in the following entitled cause:

VICTOR H. and ELSIE AKIN,
FRED C and ALICE M. KLUVER,
E F and GLADYS MUNROE,

Plaintiffs,

vs.

UNITED STATES OF AMERICA,

Defendant.

Civil 4710

Complaint.
(For Refund of Taxes)

1) 1. This action is brought under Title 28, United States Code, Annotated, Section 1346, for the recovery of taxes illegally and erroneously collected.

2. The aggregate amount of the claims does not exceed $10,000.

3. The taxes in controversy were collected by Ralph M. Nicholas as collector of internal revenue for the district of Colorado. The said Ralph M. Nicholas is not in office as such collector or as director of internal revenue at the time of the commencement of this action.

4. Plaintiffs have joined in one action pursuant to

Rule 20(a) of the Federal Rules of Civil Procedure. The right to relief asserted by plaintiffs arises out of the same series of occurrences, and questions of fact and law common to all of the plaintiffs will arise in the action.

2) 5. Plaintiffs Victor H. and Elsie Akin (sometimes herein called the Akins), plaintiffs Fred C. and Alice M. Kluver (sometimes herein called the Kluvers) and plaintiffs E. M. and Gladys Munroe (sometimes herein called the Munroes) are, respectively, husband and wife and were during all times herein mentioned.

6. The Akins, the Kluvers, and the Munroes each filed timely joint income tax returns for the taxable years ended December 31, 1949 and December 31, 1950, with the collector of internal revenue for the district of Colorado and paid to the said collector the taxes shown to be due thereon.

7. During the said taxable years the Akins, the Kluvers, and the Munroes each were engaged in the trade or business of farming and the cost of water for irrigation was an ordinary and necessary expense of carrying on such trade or business.

8. During the said taxable years the Akins, the Kluvers, and the Munroes, each obtained such water for irrigation from one or both of two companies, namely, the Water Supply and Storage Company and the North Poudre Irrigation Company.

9. The Water Supply and Storage Company was incorporated July 31, 1891 and the North Poudre Irrigation Company was incorporated July 31, 1901. Both of said companies are and at all times herein mentioned were incorporated and existing as mutual ditch companies under the authority of Article 7, Chapter 41, 1935 Colorado Statutes Annotated.

10. Said companies are authorized by law to levy annual assessments upon their stockholders and to collect the same under penalty of withholding all water for irrigation in the event of nonpayment.

11. Each of said companies has more than 300 stockholders and owns property having a value of many hundreds of thousands of dollars. Neither the Akins, the Kluvers, nor the Munroes, nor all of them, have any control whatsoever over either of the said

companies or the amount of the annual assessments levied by said companies.

3) 12. During the said taxable years the Akins, the Kluvers, and the Munroes each paid the respective annual assessments for the said taxable years levied upon them by one or both of the said companies, and deducted the amounts so paid as ordinary and necessary business expenses in the income tax returns filed by them respectively for each of the said taxable years.

13. The said returns were examined by an internal revenue agent and a portion of the deductions taken for such ordinary and necessary expenses of obtaining water for irrigation by the Akins, the Kluvers, and the Munroes for each of said years was disallowed by the said agent for each of the said taxable years on the ground that the portion so disallowed was used by the mutual ditch company to which it was paid for expenditures of a capital nature.

14. In computing the amounts allegedly so used by the said companies for expenditures of a capital nature, the said agent failed to allow any depreciation to either of said companies. Allowance of depreciation in the amounts properly allowable to each of said companies would completely eliminate or reduce to an insignificant amount any such capital expenditures of either of said companies for each of the said taxable years.

15. After conference the defendant's representatives sustained the said disallowances made by the said agent, and on November 4, 1952, plaintiffs paid to the collector of internal revenue for the district of Colorado additional taxes for the said years of which the following amounts were attributable to said disallowances.

Taxable Year Ended December 31,

	1949	1950
Akins	$ 637.62	
Kluvers	1,816.72	$3,517.18
Munroes	18.52	2,053.98

16. In addition, the Commissioner of Internal Revenue allowed to the Akins a refund arising by reason of other adjustments conceded by the defendant to be correct, for the taxable year ended December 31, 1950, in the amount of $613.72 instead of in the amount of $1,190.63, by which the said Akins overpaid their income tax for the said year, thus reducing said refund in the amount of $576.91 on account of said disallowance.

4) 17. On May 12, 1953, and within the time provided therefor by law, plaintiffs, respectively, filed with the director of internal revenue for the district of Colorado claims for refund for each of the said amounts for each of the said years set forth above. A copy of each of said claims is attached hereto and said claims are marked Exhibits A to F, inclusive. On February 24, 1954, and within the time provided therefor by law, plaintiffs, respectively, filed amended claims for refund. A copy of each of said amended claims is attached hereto and marked Exhibits G to L, inclusive.

18. Except in the case of Akins with respect to the taxable year ended December 31, 1950, plaintiffs have paid to the collector of internal revenue for the district of Colorado, or to the director of internal revenue for the said district, interest on said erroneous and illegal additional taxes for each of said years at the rate and for the period provided by law to date of payment of said taxes.

19. The respective amounts of taxes and interest set forth above were illegally and erroneously collected from plaintiffs contrary to the laws pertaining to internal revenue.

20. On September 8, 1953, George H. Allan, director of internal revenue for the district of Colorado, addressed a letter to each of the plaintiffs, respectively, denying the claims filed by such plaintiffs, respectively. Copies of said letters are attached hereto and marked Exhibits M, N, and O, respectively.

21. More than six months have elapsed since plaintiffs filed their respective original claims for refund with defendant.

5) Wherefore, plaintiffs pray:

(a) Judgment against defendant for the following

amounts:

Akins	$1,214.53
Kluvers	5,333.90
Munroes	2,072.50

and for interest paid thereon, together with interest on said amounts as provided by law from dates of payment as aforesaid.

(b) Their costs in this behalf expended, and such other and further relief as to the Court may seem proper.

Stanley L. Drexler.

Filed May 25, 1954.

Amendment to Complaint.

The complaint in the above entitled action is hereby amended as follows:

1. Paragraph 20 is stricken, and in its place is substituted:

On September 8, 1953, George H. Allan, Director of Internal Revenue for the District of Colorado, addressed a letter to each of the plaintiffs, respectively, denying the claims for refund (Exhibits A to F, inclusive) filed by such plaintiffs on May 12, 1953. Copies of said letters are attached hereto and marked Exhibits M, N and O, respectively.

2. Paragraph 21 is stricken, and in its place is substituted:

On June 24, 1954, said George H. Allan addressed a letter to each of the plaintiffs, respectively, denying the amended claims for refund (Exhibits A to F, inclusive) filed by such plaintiffs on February 24, 1954. Copies of the latter letters

United States vs. Victor H. and Elsie Akin, et al.

are attached hereto and marked Exhibits P, Q and R, respectively.

Stanley L. Drexler,
Attorney for the Plaintiffs.

[Exhibits attached to amendment not reproduced.]

Filed July 26, 1954.

Amendment to Complaint.

13) It is stipulated by and between the parties hereto that pursuant to Rule 15(a) Federal Rules of Civil Procedure the complaint in this action is hereby amended in the following particulars:

1. The caption is amended to read:

VICTOR H. and ELSIE AKIN,
FRED C. and ALICE M. KLUVER,
E. F. and GLADYS MUNROE,

Plaintiffs,

vs.

UNITED STATES OF AMERICA,

Defendant.

It is understood that the parties named above are the same parties named in the complaint, and that said parties were mistakenly designated therein.

2. Paragraph 5 of said complaint is amended to read as follows:

5. Plaintiffs Victor H. and Elsie Akin (sometimes herein called the Akins, plaintiffs Fred C. and Alice M. Kluver (sometimes herein called the Kluvers) and plaintiffs E. F. and Gladys Munroe (sometimes herein called the Munroes) are,

respectively, husband and wife, and were during all times herein mentioned.

14) 3. Paragraph 9 of said complaint is hereby amended to read as follows:

9. The Water Supply and Storage Company was incorporated August 8, 1891, and the North Poudre Irrigation Company was incorporated August 1, 1901. Both of said companies are, and at all times herein mentioned were, incorporated and existing as ditch and reservoir companies under the authority of Article 14, Chapter 31, 1953, Colorado Revised Statutes.

Stanley L. Drexler,
Counsel for Plaintiffs.

No objection:
Donald E. Kelley,
Counsel for Defendant.

Filed December 5, 1955.

Answer.

15) Comes now the defendant by the United States Attorney for the District of Colorado and for answer to the complaint herein alleges on information and belief as follows:

1. Defendant admits the allegations in paragraph 1 but denies that the taxes were erroneously or illegally collected.

2. Defendant admits the allegations in paragraph 2.

3. Defendant admits the allegations in paragraph 3.

4. Defendant admits the allegations in paragraph 4.

5. Defendant admits the allegations in paragraph 5.

6. Defendant admits the allegations in paragraph 6.

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7. Defendant denies knowledge or information sufficient to form a belief as to the truth or accuracy of the allegations in paragraph 7.

8. Defendant denies knowledge or information sufficient to form a belief as to the truth or accuracy of the allegations in paragraph 8.

9. Defendant denies knowledge or information sufficient to form a belief as to the truth or accuracy of the allegations in paragraph 9.

10. Defendant denies knowledge or information sufficient to form a belief as to the truth or accuracy of the allegations in paragraph 10.

16) 11. Defendant denies knowledge or information sufficient to form a belief as to the truth or accuracy of the allegations in paragraph 11.

12. Defendant denies the allegations in paragraph 12 but admits that during 1949 and 1950 the Akins, the Kluvers and the Munroes, respectively, each paid assessments to one or both of the irrigation companies and claimed the amounts so paid as deductions on their income tax returns.

13. Defendant denies the allegations in paragraph 13 but admits that the said returns were examined by an internal revenue agent and a portion of the deductions claimed by the Akins, the Kluvers and the Munroes for 1949 and 1950 was disallowed.

14. Defendant denies the allegations in paragraph 14.

15. Defendant admits the allegations in paragraph 15 but denies that all payments were made on November 4, 1952.

16. Defendant denies the allegations in paragraph 16 but admits that the Commissioner of Internal Revenue allowed to the Akins a refund for the taxable year ended December 31, 1950, in the amount of $613.72 plus interest.

17. Defendant denies the allegations in paragraph 17 but admits that on May 3, 1953, the plaintiffs filed with the Director of Internal Revenue for the District of Colorado claims for refund for 1949 and 1950. Copies of each of said claims are

attached to the complaint as Exhibits A to F, inclusive. On February 26, 1954, the plaintiffs filed amended claims for refund and copies of said amended claims are attached to the complaint as Exhibits E to F, inclusive. The substantive allegations of these claims not otherwise admitted in this answer are denied.

18. Defendant denies the allegations in paragrapn 18 but admits that the plaintiffs have paid interest assessed in respect to the additional taxes referred to in paragraph 15.

17) 19. Defendant denies the allegations in paragraph 19.

20. Defendant denies the allegations in paragraph 20, but admits that on September 8, 1953, George H. Allen, Director of Internal Revenue for the District of Colorado, addressed a letter to each of the plaintiffs respectively proposing to deny the claims filed by such plaintiffs. Copies of said letters are attached to the complaint as Exhibits M, N and O.

21. Defendant admits the allegations in paragraph 21.

Wherefore, defendant demands judgment that plaintiff's complaint be dismissed, together with the costs of this action.

Donald E. Kelley,
United States Attorney,
Attorney for the Defendant.

Filed October 20, 1954.

Motion for Summary Judgment.

18) Come now the plaintiffs by their attorney, Stanley L. Drexler, and move the Court to enter summary judgment in the above-entitled action in favor of plaintiffs and against the defendant.

For grounds for this motion, the plaintiffs state and show unto the Court that under the pleadings, stipulation and exhibits attached to said pleadings and stipulation on file in said

action there is no genuine issue as to any material fact and that the plaintiffs are entitled to a judgment in their favor as a matter of law.

Stanley I. Drexler,
Attorney for Plaintiffs.

Filed: August 19, 1955.

Motion of The United States For Summary Judgment.

19) Defendant, United States, moves the Court to enter, pursuant to Rule 56 of the Federal Rules of Civil Procedure, a summary judgment in the defendant's favor dismissing this action on the ground that there is no genuine issue as to any material fact and that the defendant is entitled to a judgment as a matter of law.

The motion is based upon

(a) The pleadings on file in this action, consisting of the plaintiffs' complaint and the defendant's answer thereto.

(b) The stipulation of facts with attached exhibits agreed to by the plaintiffs and defendant.

Donald E. Kelley,
United States Attorney.

Filed August 30, 1955.

Stipulation.

20) Counsel for the parties hereto stipulate and agree that the following facts are true and may be found as facts by the Court herein and that the attached exhibits may be considered as evidence in this action:

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1. Plaintiffs Victor H and Elsie Akin (sometimes herein called the Akins), plaintiffs Fred C. and Alice M. Kluver (sometimes herein called the Kluvers) and plaintiffs E. F. and Gladys Munroe (sometimes herein called the Munroes) are, respectively, husband and wife and were during all times herein mentioned.

2. The Akins, the Kluvers, and the Munroes each filed timely joint income tax returns for the taxable years ended December 31, 1949, and December 31, 1950, with the Collector of Internal Revenue for the District of Colorado and paid to the said Collector the taxes shown to be due thereon.

3. The Akins and the Kluvers for the years 1949 and 1950 filed income tax returns on the basis of cash receipts and disbursements and of the calendar year. The Munroes for the years 1949 and 1950 filed income tax returns on the accrual and calendar year basis.

4. During the said taxable years the Akins, the Kluvers, and the Munroes each were engaged in the trade or business of farming.

5. During the said taxable years, Victor H Akin, Elsie Akin, Fred C. Kluver, Alice M Kluver, and E. F. Munroe were stockholders in and obtained water for irrigation of their farms from the North Poudre Irrigation Company. During said taxable years Victor H. Akin, Fred C. Kluver and Alice M. Kluver were stockholders in and obtained water for irrigation of their farms from the Water Supply and Storage Company. Some of the plaintiffs obtained water from other sources.

21) 6. The Water Supply and Storage Company was incorporated August 8, 1891, and the North Poudre Irrigation Company was incorporated August 1, 1901. Both of said companies are and at all times herein mentioned were incorporated and existing as ditch and reservoir companies under the authority of Article 14, Chapter 31, 1953, Colorado Revised Statutes. True and correct copies of the Articles of Incorporation and By-laws of the Water Supply and Storage Company and the North Poudre Irrigation Company in force during 1949 and 1950 are attached hereto and are designated Exhibits P-1 and Q-2, respectively.

7. The stock holdings of the Akins, the Kluvers and the Munroes in the Water Supply and Storage Company and the North

Poudre Irrigation Company for 1949 and 1950, the total number of shares outstanding and the number of shareholders in those companies, as shown by the books and records of said companies, were as shown on the attached Exhibits R-3 and S-4.

8. During the said taxable years the Akins, the Kluvers, and the Munroes each paid the respective annual assessments for the taxable years levied upon them by one or both of the said companies, and deducted the amounts so paid as ordinary and neces sary business expenses in the income tax returns filed by them respectively for each of the said taxable years. Notices of assessment in the same form as those sent out to the stockholders of both companies during 1949 and 1950 are attached hereto and designated as Exhibits T-5 and U-6. True and correct copies of taxpayers' income tax returns for said years are attached hereto and designated Exhibit V-7.

22) 9. On February 7, 1949, an assessment of $11.00 per share was levied pro rata on all stock of the North Poudre Irrigation Company for the following purposes:

$3.17	per share for principal on Mortgage Note
1.05	per share for interest
3.85	per share for total maintenance, operation, etc.
.15	per share for tollage
1.50	per share for repairs on No. 15 Reservoir
1.28	per share for purchase of Right-of-Way
$11.00	Total

A true and correct copy of the stockholders' resolution authorizing said assessment and making said allocation of the assessment is attached hereto and designated Exhibit W-8.

On February 6, 1950, an assessment of $12.00 per share was levied pro rata on all stock of the North Poudre Irrigation Company for the following purposes:

$ 3.30	per share for principal payments
1.00	per share for interest
4.00	per share for total maintenance, operation and miscellaneous expenses
.40	per share for tollage
2.00	per share for equipment and current notes payable
1.30	per share for purchase of right-of-way for Colorado Big Thompson Ditch
$12.00	Total

A true and correct copy of the stockholders' resolution authorizing said assessment and making said allocation of the assessment is attached hereto and designated Exhibit X 9.

On January 12, 1949, an assessment of $195.00 per share for maintenance and operation and an assessment of $25.00 per share for the assessment of the Tunnel Water Company, a subsidiary, were levied by the stockholders of the Water Supply and Storage Company on each outstanding share of that company's stock.

On January 11, 1950, assessments in the same amounts as 1949 were levied by the stockholders. A true and correct copy of the stockholders' resolutions authorizing said assessments are attached hereto and designated Exhibits Y-10 and Z-11. The Water Supply and Storage Company owns two thirds of the outstanding stock of the Tunnel Water Company. True and correct copies of The Annual Audit Reports of North Poudre Irrigation Company for December 31, 1949, and December 31, 1950; true and correct copies of the Annual Audit Report of the Water Supply and Storage Company for the fiscal years ending November 30, 1949, and November 30, 1950, are attached hereto and designated Exhibits AA-12 and BB-13.

23) 10. During the taxable years involved the Water Supply and Storage Company and the North Poudre Irrigation Company made, the following expenditures of a capital nature:

Water Supply and Storage Company

Type Expenditures	Amount		Year
Truck	$ 1,671.30	(1)	11/30/49
Machinery	4,615.60	(1)	11/30/49
Payment on Long Term Notes	43,000.00	(1)	11/30/49
Payment on Long Term Notes	44,000.00	(2)	11/30/50
Truck	408.00	(2)	11/30/50
Machinery Purchased	175.10	(2)	11/30/50

(1) See Schedule 4 Annual Audit Report for fiscal year ending November 30, 1949.

(2) See Schedule 4 Annual Audit Report for fiscal year ending November 30, 1950.

North Poudre Irrigation Company

Type Expenditures	Amount		Year
Miscellaneous Machinery and Equipment	$ 3,847.50	(1)	1949
Long Term Notes Paid	33,300.00	(2)	1949
Equipment	11,519.20	(3)	1950
Right-of-Way for Canal	495.00	(4)	1950
Long Term Notes Paid	34,700.00	(5)	1950

(1) See Annual Audit Report, December 31, 1949, 4th page.

(2) See Annual Audit Report, December 31, 1949, 5th page.

(3) See Annual Audit Report, December 31, 1950, Cash Statement.

(4) See Annual Audit Report, December 31, 1950, 5th page.

11. A revenue agent examined the income tax returns of these taxpayers for the taxable years involved herein, and recommended the disallowance of a portion of the deductions taken by them for amounts accrued and/or paid to the aforesaid water companies on account of the aforesaid assessments, on the ground that the amounts disallowed did not constitute ordinary and necessary expenses of carrying on their farming operations, as follows, to-wit:

The Akins

Year	Company	Assessment	Amounts Disallowed
1948	Poudre	$12 a share	$1.525 per share
1949	Poudre	$11 a share	$4.45 per share
1950	Poudre	$12 a share	$4.60 per share

The Akins paid Poudre in 1949 one-half of the Poudre assessment for 1948 based on 365 shares; and the Internal Revenue agent having ascertained that $3.05 of the 1948 assessment was allocated and applied by Poudre in payment of $30,500 for retirement of principal on a mortgage note, disallowed $1.525 a share as a deduction.

The Akins paid Poudre in 1949 the sum of $4,015 based on an assessment of $11 a share for 365 shares. The Internal Revenue agent having ascertained that $3.17 a share and $1.28 a share of the assessment was allocated by Poudre for payment of $31,700 on retirement of principal of a mortgage note, and $12,800 for the purchase of a Right-of-Way, disallowed $4.45 a share as a deduction.

The Akins paid Poudre in 1950 the sum of $4,380 based on an assessment of $12 a share for 365 shares. The Internal Revenue agent having ascertained that $3.30 a share and $1.30 a share of the assessment was allocated by Poudre for payment of $33.000 on retirement of principal of a mortgage note, and $13,000 for the purchase of a Right-of-Way, disallowed $4.60 a share as a deduction.

The Akins

Year	Company	Assessment	Amounts Disallowed
1949	Water Supply	$220 a share	$71.66 2/3 per share
1950	Water Supply	$220 a share	$73.33 1/3 per share

The Akins paid Water Supply Co. in 1949 the sum of $550, based on an assessment of $220 per share for 2 1/2 shares, and in 1950 paid that company the sum of $550, based on an assessment of $220 per share for 2 1/2 shares. The Internal Revenue Agent having determined that $71.66 2/3 per share of the 1949 assessment was applied by Water Supply Co. in payment of $43,000 for retirement of principal on a mortgage note; and that $73.33 1/3 per share of 1950 assessment was applied by Water Supply Co. in payment of $44,000 for retirement of principal on a mortgage note, disallowed $71.66 2/3 for 1949, and $73.33 1/3 for 1950 a share, as a deduction.

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The Kluvers

Year	Company	Assessment	Amounts Disallowed
1949	Water Supply	$220 a share	$71.66 2/3 per share
1950	Water Supply	$220 a share	$73.33 1/3 per share

25) The Kluvers paid Water Supply Co. in 1949 the sum of $3,080 based on an assessment of $220 a share for 14 shares, and in 1950 paid that company the sum of $3,080 based on an assessment of $220 a share for 14 shares. The Internal Revenue agent having determined that $71.66 2/3 per share of the 1949 assessment was applied by Water Supply Co. in payment of $43,000 for retirement of principal on a mortgage note, and that $73.33 1/3 per share of 1950 assessment was applied by that company in payment of $44,000 for retirement of principal on a mortgage note, disallowed $71.66 2/3 for 1949, and $73.33 1/3 for 1950 a share as a deduction.

The Kluvers

Year	Company	Assessment	Amounts Disallowed
1949	Poudre	$11 a share	$4.45 per share
1950	Poudre	$12 a share	$4.60 per share

The Kluvers paid Poudre in 1949 the sum of $4,587 based on an assessment of $11.00 a share for 417 shares. The Internal Revenue agent having ascertained that $3.17 a share and $1.28 a share of the assessment was allocated by Poudre for payment of $31,700 on retirement of principal of a mortgage note, and $12,800 for the purchase of a Right-of-Way, disallowed $4.45 a share as a deduction.

The Kluvers paid Poudre in 1950 the sum of $3,804 based on an assessment of $12 a share for 317 shares. The Internal Revenue agent having ascertained that $3.30 a share and $1.30 a share of the assessment was allocated by Poudre for payment of $33,000 on retirement of principal of a mortgage note, and $13,000 for the purchase of a Right-of-Way, disalloed $4.60 a share as a deduction.

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The Munroes

Year	Company	Assessment	Amounts Disallowed
1949	Poudre	$11 a share	$4.45 per share
1950	Poudre	$12 a share	$4.60 per share

26) The Munroes paid Poudre in 1949 the sum of $1,177 based on an assessment of $11 a share for 107 shares. The Internal Revenue agent having ascertained that $3.17 a share and $1.28 a share of the assessment was allocated by Poudre for payment of $31,700 on retirement of principal of a mortgage note, and $12,800 for the purchase of a Right-of-Way, disallowed $4.45 a share as a deduction.

The Munroes paid Poudre in 1950 the sum of $1,284 based on an assessment of $12 a share of 107 shares. The Internal Revenue agent having ascertained that $3.30 a share and $1.30 a share of the assessment was allocated by Poudre for payment of $33,000 on retirement of principal of a mortgage note, and $13,000 for the purchase of a Right-of-Way, disallowed $4.60 a share as a deduction.

12. After conference, the defendant's representatives sustained the said disallowances made by the said agent, and on November 4, 1952, plaintiffs paid to the Collector of Internal Revenue for the District of Colorado additional taxes for the said years of which the following amounts were attributable to said disallowances:

	Taxable Year Ended December 1	
	1949	1950
Akins	$ 637.62	
Kluvers	1,816.72	$3,517.18
Munroes	18.52	2,053.98

13. In addition, the Commissioner of Internal Revenue allowed to the Akins a refund arising by reason of other adjustments conceded by the defendant to be correct, for the taxable year ended December 31, 1950, in the amount of $613.72 instead of the amount of $1,190.63, by which the said Akins allege they overpaid their income tax for the said year, thus reducing said refund in

the amount of $576.91 on account of said disallowance.

27) 14. A photostatic copy of the form of stock certificate used by the Water Supply and Storage Company is attached hereto and is designated Exhibit CC-14. A photostatic copy of the form of stock certificate used by The North Poudre Irrigation Company is attached hereto and designated DD-15. It is, however, agreed that the person or persons appearing thereon as owner or owners of said stock, the certificate numbers, the number of shares, the issuance date and the signatures of the Secretary and President thereon have nothing to do with this action and that said certificate is to be considered as if it were unissued.

15. Certificates of Assessments and Payments of income tax for the taxpayers for the years involved are attached hereto and designated Exhibit EE-16.

Stanley L. Drexler,
Attorney for Plaintiffs.

Approved and Agreed to:

Donald E. Kelley,
Attorney for Defendant.

/Exhibits to Stipulation not reproduced./

Filed August 31, 1955.

Amendment to Stipulation of Parties.

28) The parties to this action hereby amend their stipulation of facts on file with the Clerk of the United States District Court in the following particulars:

1. Paragraph 12 is stricken and the following paragraph 12 is substituted in its stead:

12. After conference, the defendant's representatives sustained the said disallowances made by the said agent and the plaintiffs paid to the Collector of Internal Revenue for the

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District of Colorado additional taxes for the said years of which the following amounts were attributable to said disallowances:

	1949	Assessed Interest
Akins	$ 606.72	$ 96.13
Kluvers	1,135.90	164.25
Munroes	182.14	2.93

	1950	Assessed Interest
Akins	$.....	$.....
Kluvers	1,135.90	154.56
Munroes	237.38	23.97

Stanley L. Drexler and
Ellis J. Sobol, by
Ellis J. Sobol,
Attorneys for Plaintiffs.

Robert Swanson, Assistant
United States Attorney,
Attorney for Defendant.

Filed June 22, 1956.

Order.

29) This matter coming on to be heard this 31st day of August, 1955, upon plaintiffs' motion for summary judgment, and defendant's cross-motion for summary judgment, the plaintiffs being represented by Stanley L. Drexler, Attorney at Law, and the defendant being represented by Leland T. Atherton, Tax Division, Attorney General's Office;

And the Court having read the Stipulation of the parties, considered defendant's briefs and having considered the arguments of counsel;

It is ordered:

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That plaintiffs' motion for summary judgment is denied, and that defendant's cross-motion for summary judgment is denied, both on the ground that there are outstanding unresolved fact questions; and

It is further ordered:

That this matter be set down for trial.

Done in open Court this 12 day of September, 1955.

By the Court:

Jean S. Breitenstein, Judge.

Filed September 12, 1955.

Findings of Fact; Conclusions of Law and Judgment.

31) This matter coming on to be heard on the 22nd day of June, 1956, the plaintiffs being represented by Stanley L. Drexler, Esq., and Ellis J. Sobol, Esq., and the defendant being represented by Robert Swanson, Esq., Assistant U. S. Attorney for the District of Colorado, and the Court having considered the testimony of the witnesses, read the pleadings, examined the evidence introduced, having heard the statements of counsel and being fully advised in the premises, the Court doth find as follows:

1. The facts stipulated by the parties are so found.

2. This is an action for refund of income taxes paid by plaintiffs to the United States.

3. The plaintiffs, Victor H. and Elsie Akin, Fred C. and Alice M. Kluver and E. F. and Gladys Munroe were husband and wife during all times relevant herein.

4. The plaintiffs each filed timely joint individual federal income tax returns for the taxable years ended December 31, 1949, and December 31, 1950, with the Collector of Internal

Revenue for the District of Colorado and paid to the said Collector the taxes shown to be due thereon.

5. During the said taxable years the plaintiffs each were engaged in the business of farming.

6. During the said taxable years, Victor H. Akin and Elsie Akin, Fred C. and Alice M. Kluver and E. F. Munroe were stockholders in and obtained water for irrigation of their farms from the North Poudre Irrigation Company. During said taxable years Victor H. Akin, Fred C. and Alice M. Kluver were stockholders in and obtained water for irrigation of their farms from The Water Supply and Storage Company.

32) 7. The North Poudre Irrigation Company and The Water Supply and Storage Company are both corporations not for profit, organized under Colorado law. They distribute water to farmers who use the water for the growing of agricultural crops.

8. During each of the years involved each of the companies levied annual assessments on their stockholders. The plaintiffs herein paid the assessments so levied and deducted the amounts paid on their federal income tax returns as ordinary and necessary business expenses of farming.

9. The Commissioner of Internal Revenue disallowed that portion of the assessments so paid and deducted which was allocated or spent by the companies for expenditures of a capital nature and debt retirement and assessed deficiencies in income tax against the plaintiffs.

10. The plaintiffs paid the assessed deficiencies on November 4, 1952, to the Collector of Internal Revenue for the District of Colorado, the following amounts paid being attributable to the disallowance of the deduction of a portion of the assessments paid:

	1949	Assessed Interest	1950	Assessed Interest
Akins	$ 606.72	$ 96.13	$.....	$.....
Kluvers	1,135.90	164.25	1,135.90	154.56
Munroes	182.14	2.93	237.38	23.97

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11. For the taxable year 1950 the Commissioner of Internal Revenue allowed the Akins a refund in the amount of $613.72 arising out of adjustments not here involved and conceded by defendant to be correct, instead of the amount of $1,190.63, by which the Akins alleged they overpaid their tax for the year. The amount overpaid attributable to the aforesaid disallowance of deduction of a portion of the assessment paid to the said companies is $576.91.

33) 12. On May 12, 1953, the plaintiffs filed with the Director of Internal Revenue for the District of Colorado claims for refund for each of the said amounts for each of the years as set forth above.

13. More than six months elapsed from the time plaintiffs filed their claims for refund until the time of filing of this suit.

14. The plaintiffs used substantially all the water obtained from the companies in their business of farming. (In one year involved, Mr. Kluver rented a small amount of water to a neighbor as an accommodation.)

15. The assessments made by the companies had to be paid in order for the plaintiffs to obtain water. If the assessments had not been paid, plaintiffs' water would have been shut off and their stock could have been sold. In paying the assessments, the plaintiffs' intention in each case was to assure the delivery of water, if available, and not to make a contribution to the capital of the corporations.

16. The expenditures by the companies out of the monies obtained from the assessments were made merely to assure the continued availability of water divertible under the water rights held by the companies in trust for the stockholders.

17. The value of the stock of the companies here involved is in the water rights and the expenditure of new money does not add to the yield of the water rights.

18. It is common knowledge that on the Eastern Slope of Colorado the streams have been over-appropriated for many, many years and that there has not been ecough water to satisfy agricultural needs.

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Conclusions of Law.

34) The Court has jurisdiction of the parties and of the subject matter of this action.

19. Under Colorado law, a water right, i. e., the right to divert water from a natural stream and put it to beneficial use, is owned by he who actually puts the water to beneficial use and is not owned by the ditch or reservoir companies which are devices for getting the water to the users.

20. Under Colorado law, a water right is a distinct usufructuary estate, or a right in property.

21. Under Colorado law, non-user of a water right results in an abandonment of such right.

22. Under Colorado law, the stock certificates of a mutual ditch, irrigation or reservoir company such as the companies here involved represent only the right to receive water and they are not personal property but real property.

23. The expenditures made by the companies here involved did not create capital within the meaning of the 1939 Internal Revenue Code.

24. Amounts paid by plaintiffs, farmers, pursuant to stock assessments by Colorado mutual ditch and irrigation companies, not for profit, the payment of such assessments to the companies being a condition precedent to the right to receive water for irrigation of their farms, and the water so obtained being used for the irrigation of their farms, constituted ordinary and necessary expenses paid or incurred during the taxable year in carrying on their farming business within Sec. 23 (a) (1) 1939 Internal Revenue Code and hence were deductible in full from gross income.

25. The income taxes and interest here involved were illegally and erroneously collected by the United States.

35) Accordingly, it is adjudged and decreed that the plaintiffs are entitled to receive refunds of taxes and interest and that the defendant shall pay such refunds in the following amounts:

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1949

	Tax Overpayment	Interest Overpayment	Total Refund
Akins	$ 606.72	$ 96.13	$ 702.85
Kluvers	1,135.90	164.25	1,300.15
Munroes	182.14	2.93	185.07

1950

	Tax Overpayment	Interest Overpayment	Total Refund
Akins	$ 576.92	$.....	$ 576.92
Kluvers	1,619.26	154.56	1,773.82
Munroes	237.38	23.37	260.75

	1949 and 1950 Total Refund
Akins	$1,279.77
Kluvers	3,073.97
Munroes	445.82

Plus interest in each case as provided by law.

Done this 22nd day of June, 1956, in open court.

Jean S. Breitenstein, Judge,
United States District Court
for the District of Colorado.

Entered on the docket, June 22, 1956, G. Walter Bowman, Clerk.

Notice of Appeal.

36) Notice is hereby given that the above-named defendant, the United States of America, hereby appeals to the

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United States Court of Appeals for the Tenth Circuit from the final judgment entered herein by the United States District Court for the District of Colorado on the 22nd day of June, 1956.

Donald E. Kelley,
United States Attorney for
the District of Colorado.

Robert Swanson, Assistant U. S.
Attorney for the District of
Colorado.

Filed August 16, 1956.

An order was entered September 14, 1956, extending the time to docket the appeal to November 14, 1956.

Transcript of Trial Proceedings.

40) Proceedings had before Honorable Jean S. Breitenstein, Judge, United States District Court for the District of Colorado, Post Office Building, Denver, Colorado, in Courtroom B, commencing at 3:15 p.m., on Monday, March 19, 1956.

Appearances: Stanely L. Drexler and Ellis J. Sobol, Attorneys at Law, 516 Mile High Center, Denver, Colorado, appearing for the Plaintiffs. Robert Swanson, Assistant United States Attorney, Post Office Building, Denver, Colorado; and Theodore Garver, Attorney, Tax Division, Department of Justice, Washington, D. C., appearing for the Government. Arthur Biggins, Attorney, Tax Division, Department of Justice, Washington, D. C., appearing with Robert Swanson at the May 8, 1956, final day of the trial.

42) The Court. We have set for trial now Civil Action No. 4710, Victor H. Akin, et al, against the United States. Are the plaintiffs ready?

Mr. Drexler: Plaintiffs are ready, Your Honor.

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The Court Is the defendant ready?

Mr. Garver: Defendant is ready, Your Honor.

The Court: Proceed.

Mr. Drexler: I shall breifly state the case for the plaintiff, Your Honor.

The Court: Very well.

Mr. Drexler: This is an action for a refund of taxes paid for the years 1949 and 1950 by the plaintiffs, who are Victor H. and Elsie Akin, Fred C. and Alice M. Kluver, E. F. and Gladys Munroe. The plaintiffs are farmers. In each case, Your Honor, joint returns were filed, and I shall speak of the man in each case as the taxpayer, although the wives are parties in each case. The plaintiffs are farmers. They farm in the Fort Collins area. They obtain their water from one of two mutual irrigation companies, the North Poudre Irrigation Company and the Water Supply and Storage Company. The sole question presented by this case is the deductibility as an ordinary business expense of the annual assessments paid by the plaintiffs for each of these two years, levied upon them as stockholders of one or both of these two mutual irrigation companies. The Government has disallowed that portion of the assessment which was levied, as I understand the theory of the Government's disallowance, for the purpose of retiring a portion of the indebtedness of the mutual ditch companies or in one case for the acquisition of the right-of-way. The Government's theory, in other words, is that the assessments are deductible only to the extent that the corporation to which the assessments are paid uses those assessments for maintenance as distinguished from capital expenditures.

43) It is the plaintiffs' theory that the entire amount of the annual assessments is deductible, that no portion of the assessment constitutes a contribution to the capital of the corporation and that the taxing authorities may not look behind or look through the corporate entities and consider that these assessments are only deductible to the extent that the corporation uses them for purposes which would be deductible by the corporation.

In that respect I might state that in the argument

ing on the motions for summary judgment previously filed by both sides, there was considerable discussion between counsel for the taxpayer and counsel for the Government as to how depreciation fits into this picture. No part of the assessment, I believe the evidence will show, was levied for the purpose of enabling the ditch companies to replace their depreciable structures, which are reservoirs which are silting up and which also consist of concrete structures and head gates and flumes and things of that sort.

44) It is the plaintiffs' contention, and this is an alternative position, that if it is necessary to look into what the company does with the assessments in order to determine whether what the stockholder pays is a deductible expense or in part a contribution to the corporation capital, if that is the way you look at it, although the Government states they are not disregarding the corporate entity, it seems to us that what the Government is doing is to say to these farmers, "We will treat the assessments that you have paid the same way that your mutual corporation would be entitled to treat them." Now, if that is the Government's theory, then we say that the corporation is entitled, just as the individuals would be entitled; if they were themselves maintaining these ditches and reservoirs, they would certainly be entitled to deduct a reasonable allowance for depreciation for the gradual loss of the useful economic and physical life of these structures, and if you look at it that way the depreciation largely wipes out what would otherwise be capital expenditures by the corporation. Therefore, we are prepared and shall offer evidence as to what that depreciation was, although the Government counsel has previously indicated that the Government will object to the introduction of any of that evidence as irrelevant. As I say, I don't know why it is not relevant, but I will let counsel for the Government speak for themselves.

45) After motions had been filed on both sides for a summary judgment based upon a partial stipulation of facts, the Court indicated that it believed that testimony was necessary in order to enable a proper decision to be made in this case, that testimony going to the nature of the investment made by the plaintiffs in this case, the use to which the water obtained under the water rights of the plaintiffs and others and carried through the ditch company is put, the purpose of the investment in the stock of the company, the place of use of the water, whether a ready market existed for the stock, and other matters of that kind should be introduced. That testimony we are prepared to offer, as well

as testimony on depreciaton, and we also are prepared to offer, through one expert witness, testimony as to the general nature and purpose and function of a mutual irrigation company and its relation to the business of farming as it is carried out in Colorado and other places in the West where the priority system obtains.

That concludes our statement of the case.

Mr. Garver: As the Court knows, this is a suit for refund of taxes. Exactly what we have here is a situation where a farmer, several farmers, paid money to a mutual ditch company and they treated that as a deductible item on their returns. The Government has disallowed as a deduction that part of the assessment of these mutual ditch companies which was used for capital purposes, that is, either to retire bonds or to purchase capital items. I believe it has been stipulated that there were substantial payments of bonded indebtedness and also that there were purchases of items which I think it is conceded are capital items. So that we don't have very much of a factual dispute in this case.

46) The plaintiffs contend that the Government is trying to to pierce the corporate entity. That is not my understanding of the case at all. You have here a situation where a man has paid money to a corporation. Now, as the Court well knows, a man can pay money to a corporation for the purpose of investing in that corporation by buying stock or he can pay money to a corporation for the purpose of obtaining some of its products or services. Now, I think it is beyond any doubt that there is no necessity for piercing the corporate veil in order to have a situation where a man has paid money to a corporation in order to buy its stock, and that is our position here, and we are not making any contention that the corporate entity should be ignored or that the corporation was a sham, or the two corporations, rather.

Now, on this depreciation--

The Court: Let me be sure I understand that. It is your position, then, that these amounts which are disallowed by the Commissioner represent payments made by these individuals on account of capital stock of the corporation, on account of the purchase by them of capital stock of the corporation?

47) Mr. Garver: No, sir.

The Court Explain it to me a little more, then, will you?

Mr. Garver: They were not purchasing stock.

The Court. What were they doing?

Mr. Garver: We are contending they were contributing to the capital of the corporation, and, as you know, that is the same sort of thing as purchasing stock. A man enhances the value of the stock he already owns.

The Court: So you say, then, that each year these amounts were not allowed they were making voluntary contributions to these corporations which had the effect of enhancing the value of their stockholdings?

Mr. Garver. I don't think they were voluntary, Your Honor. I think they were necessary if the farmers were to get the water which they needed in their farming business. No, we don't contend that they are voluntary but otherwise that is our contention.

The Court: Well, they are voluntary, aren't they? They didn't have to.

Mr. Garver: Well, I suppose strictly speaking, they didn't have to pay that, but then we wouldn't get any water for the next year, I believe is the way it would work out. Isn't it true that the water is stopped for the following year if the assessments for the previous year are not paid?

48) Mr. Drexler: It is in the same year, I believe, Your Honor.

Mr. Garver: Well, at any rate, I wouldn't call that completely voluntary, but in a sense it is. I suppose there is no legal compulsion to make them pay this money.

Now, on the depreciation issue which the plaintiff has tendered, you don't have the same situation at all; you have a situation where depreciation has been sustained by a corporation, and I know of no theory where a deduction like that can be transferred over to the stockholders or, for that matter, the customers

of the corporation. I am frank to say that I don't understand the plaintiffs' theory on that, and as the plaintiffs' counsel has indicated, the Government will object to consideration of evidence on depreciation on the ground of irrelevancy. On the one hand, you have a situation where it is a payment to an admittedly valid corporation which can be one of two things, but the depreciation is not the same thing. It cannot be one of two things. It is depreciation, assuming there is some depreciation, sustained by a corporation on its own assets, and unless plaintiffs are prepared to say that this corporate entity has no valid existence, I can't see how that evidence would be material.

Now, with regard to the equities of this case, it struck me, the moment I first picked up the file, that the equities certainly are against the Government here. These farmers had to make these payments in order to obtain water, and I can very well see why all farmers would think that they would be entitled to treat them as being deductible. However, this case, to me, is just one side of a coin. The other side of the coin is that unless these payments are treated as contributions to the capital of these mutual ditch companies, in my opinion, the mutual ditch companies will lose their status as exempt corporations under Section 101.10 of the Internal Revenue Code of 1939 and I believe that that is continued and unchanged language in Section 5012 of the Internal Revenue Code of 1954. The reason for that is that this section provides that a mutual ditch company should be exempt from taxation if 85 percent or more of their income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

49) Now, I don't think that there is any doubt that these amounts collected here were not for the sole purpose of meeting losses and expenses. They are also for capital purposes. But I believe that the reason these mutual ditch companies were granted exemption in the taxable years in suit, and always have been, for that matter, except, I believe, when the North Poudre Company had some oil income, was that these assessments were not considered as income. So that what was considered income was the portion of the assessments levied to meet the ordinary expenses, the ditch riders and things like that. So that 85 percent of what was considered income did go to meet losses and expenses. The other portion was considered as being a contribution to the capital of the mutual ditch company and therefore not income.

50) Now, I believe that I am correct in stating that the only way that the entire assessments can be considered deductible is to consider the entire assessment as having been paid for the service or the product, the water, that is, and in that event I think it is clear that the money would be income to the mutual ditch company. In that situation, of course, then, you would not have 85 percent of the income used for the sole purpose of meeting losses and expenses. So that what the Government is really arguing for here is consistent treatment. I frankly don't know whether it would mean more revenue to the Government to win or lose this case. But I would like to mention that so that the equities do not appear as strongly against the Government as they do at first glance.

The Court: Well, I think I understand that, Mr. Garver. This case bothers me in many ways. That is one way it bothers me. It looks like for the application of Federal Income Tax Laws the farmers around here are going to have to change their ways of doing business.

Mr. Garver: I admit that either way this case is decided there may be considerable administrative difficulties in applying the decision throughout all the people involved. There will be less difficulty, perhaps, if the Government loses the case, because in that event there will only be the company's books to reexamine. But, as I say, it has to be decided one way or another, and of course the Government wouldn't be defending this case unless we thought we were correct in the first instance, but the revenue involved in this case or even the decision in this case as a precedent is not of over-all importance to the Government. It is the consistency of treatment.

51) The Court. All right. Let's hear what oral testimony or what evidence you have to present.

Mr. Drexler: All right, Your Honor, I will save my comment on this other question until time for final argument. I call Mr. Kluver, please.

Fred C. Kluver, called as a witness on behalf of the plaintiffs, was examined and testified as follows:

Direct Examination By Mr. Drexler.

Q. Will you state your name, please? A. Fred C. Kluver.

Q. Where do you reside, Mr. Kluver? A. Fort Collins.

Q. What is your address? A. 1527 Matthews.

Q. What is your occupation, Mr. Kluver? A. Livestock and farming.

52) Q. Were you engaged in that occupation during 1949 and 1950? A. All my life.

Q. During 1949 and 1950 were you a stockholder in the North Poudre Irrigation Company? A. Yes.

Q. And the Water Supply and Storage Company? A. Yes.

Q. Where does your land lie, the land owned by you lie with relation to those two? A. In Larimer and Weld County.

Q. Are you along both of those ditches? A. Both of the ditches, yes.

Q. How far are those two ditches from each other, Mr. Kluver? A. Well, there are places it is possibly three miles, then it varies.

Q. Are you a stockholder in both companies? A. Yes.

Q. When did you first become a stockholder in each company? A. Well, I first became a stockholder, I acquired the land through my father and we also had land before, practically all my life our family has been at it.

Q. You have been a stockholder, you or your father before you-- A. For 70-some years.

Q. Will you state, if you know, for what purpose you became a stockholder in these companies? A. For irrigating the land we had under these ditches in order to raise a crop.

53) Q. What does ownership of the stock in these companies have to do with obtaining water for irrigation, Mr. Kluver? A. I didn't just exactly get your question.

Q. What happens, I mean is it necessary to be a stock

holder in these companies? A. No; no, it is not. You can rent water.

Q. Did you purchase any stock in these companies? A. Yes.

Q. Did you purchase the stock as an investment? A. No.

Q. Why did you purchase it? A. For irrigation purposes, to raise a crop.

Q. During 1949 and 1950, Mr. Kluver, did you use all of the water which you obtained through these ditches? A. I believe we did. Some years we even rented water from other people.

Q. Do you know whether either of these companies can deliver water to persons other than stockholders of the company?

Mr. Swanson: Can now?

Q. Could during 1949 and 1950? A. They can, providing these people own land under the ditch and rent it from some of the stockholders.

54) The Court: Well, now, Mr. Kluver, under those circumstances do they rent the water from the stockholders or from the company?

The Witness: From the stockholders, Your Honor.

Q. (By Mr. Drexler) In other words, the company can deliver water only to a stockholder? A. That's right.

Q. If the stockholder then-- A. The company has no water to rent.

Q. Tell me generally, Mr. Kluver, is there more water in these ditches which is available for application to a beneficial use on the lands of the stockholders than they would like to have on their land? A. There is seldom enough.

Q. Usually, then, there is a deficiency of water? A. That's right.

Q. Mr. Kluver, have you bought or sold any land along these ditches? A. Yes.

Q. Tell, if you know, is it the practice to sell stock in the ditch companies along with the land? A. The water goes with the land.

Q. Has there been any occasions when the water stock might be sold separately from the land? A. I expect there has, but not to my knowledge. I just couldn't--I am not able to tell. I expect there has been.

55) Q. Do you know whether there is such a thing as a market for the stock of either of these companies apart from the market for the land? A. Yes, you could sell the water without the land.

Q. To whom would you sell it? A. To somebody who owns land under the ditch, the farmer.

Q. To your knowledge, has there ever been any speculation in stock of either the North Poudre or the Water Supply Company? A. No.

Q. Will you state whether it is possible to change the place of use of water obtained through these ditches? A. Only from one piece of land to the other under the same ditch.

Q. What would happen, would you give us an illustration of the circumstances under which somebody might rent some water to his neighbor? A. Well, I have a number of farms under both the Water Supply and Storage Company and the North Poudre, and there are times that one of my renters doesn't require as much water at this period, of this run of water, and I will exchange with some of my other renters and we just exchange back and forth. I have, I expect, oh, I don't know, 10 or 12 renters under these two ditches and we exchange--some weeks one renter will need more than the other; we just exchange amongst ourselves. It is all under the same system, both ditches.

56) Q. Do you know whether or not either of these companies carries any other water than that obtained by their own priorities and appropriations? A. Only through exchange. The North Poudre Supply and Water Supply and Storage Company carries

water through exchange from one ditch to the other. What I mean by that, it is a trade.

Q. Mr. Kluver, are you an officer or a director of either of these companies? A. Yes, I am.

Q. Of which one? A. The Water Supply.

Q. Do you know whether it is necessary to obtain the consent of the Board of Directors before stock in either of these companies can be sold? A. It is not.

Q. Mr. Kluver, what are you buying when you buy stock in these companies? A. Oh, buying water for the use of the land. That is the only reason I buy it for, to be used on the land. I would have no other reason.

Q. Has any of this water, to your knowledge, been used for any purpose other than irrigation? A. No, only a very small part, I believe, in fact, I know, under the Water Supply is, I think, an inch and a half pump from Black Hollow Reservoir to the new oilfield on the north of Black Hollow. That is rented by the barrel, that is, sold by the barrel, it amounts to so little.

57) Q. I think that would be a mere fraction of a percent?
A. And another, we have a meter for the Ideal Cement Company and that is very little.

Q. Have there been, to your knowledge, any situations in which a stockholder was unable or unwilling to pay his annual assessment? A. Not as I can recall. There are times that they will go borrow money to pay their assessments but it must be paid before it is turned on.

Q. Do you know what would happen if the stockholder didn't pay his assessment? A. He wouldn't get his water.

Q. Do you know whether his stock would be sold? A. It would in time.

Q. Mr. Kluver, did you make an investigation to determine the prices at which stock of the North Poudre Irrigation Company or Water Supply and Storage Company was sold at various dates? A. You will have to repeat that again.

Q. Did you give Mr. Rogers some figures as to the sale price of stock in various years? A. Yes.

58) Q. How did you arrive at those figures? A. Well, at the North Poudre I have a little--would you want it from '25 to '49?

Q. Well, just let me ask you first how you got those figures. A. That's just the market value. There is no market. It is just what one farmer has the nerve to pay for the stock, how he feels his crop needs it from one year to another. If he is short of water he is willing to even go borrow money or mortgage his land to buy stock.

Q. Well, do these figures represent what somebody actually paid? A. That's right.

The Court: Well, do they represent what somebody paid for stock or paid for water?

The Witness: For water, Judge, just for the first share.

Q. (By Mr. Drexler): Are you personally familiar with those sales? A. Oh, I am on the Board and have been for years and my father has been on the Board for 50 years and I can recall, as they are made, these sales, but I just don't--I could, yes, I could find them, where they were sold.

(Plaintiffs' Exhibit No. 1 marked for identification.)

Q. (By Mr. Drexler): Mr. Kluver, I hand you what has been marked as Plaintiffs' Exhibit 1, for identification, which consists of two columns, one column headed "Per Market Value Share of Stock for the North Poudre Irrigation Company", and another column "Long-Term Indebtedness", and similar columns for the Water Supply and Storage Company. Confining yourself now to Column 1, Per Share Market Value of Stock, will you state--and you will notice these are various dates in the case of North Poudre, from 1909 to 1950--

59) Mr. Swanson: Pardon me a moment. I must object to this. I think Counsel is certainly testifying all through this question. If there is to be any testimony regarding this exhibit it ought to be identified in a proper way and this is not

it.

The Court: Yes. Let me suggest you do that, Mr. Drexler. Identify the exhibit, but you have been doing a little testifying yourself, Mr. Drexler.

Mr. Drexler: I am sorry, Your Honor. I will rephrase the question.

Q. (By Mr. Drexler): Mr. Kluver, will you state what those figures represent? A. As far as the indebtedness of the North Poudre I would be unable to say in carrying out from year to year, but the value starting in 1909--

Mr. Swanson: If Your Honor please, I must object to this. This is not identifying the exhibit. He is testifying from it.

60) The Court: Objection sustained. Just have him identify it.

Q. (By Mr. Drexler): Would you identify the column--

The Court: No, the exhibit, what is the exhibit?

Q. (By Mr. Drexler): What is this exhibit, Mr. Kluver? A. As I see here, it is the date and the market value per share.

Q. Are you personally familiar with any of the figures there? A. Yes.

Q. Which ones? A. Well, as I run along these years I am familiar with them all.

Q. Can you tell me what they represent? A. Shares of stock.

Q. The column headed "Market Value of Stock", can you tell me how those--did you supply those figures?

Mr. Swanson: Your Honor please, I still must object to this. Counsel is trying to have an exhibit identified. He is not doing it in a proper way.

The Court: I think that is right, Mr. Drexler. What is this? Is this an exhibit which he has prepared to reflect certain things, or what is it? If it is just a written summary of what his testimony would be, that is one thing. It might be something else, I don't know.

Q. (By Mr. Drexler): Mr. Kluver, can you tell me what that exhibit is? A. As I see here, the exhibit here is what was paid for each share of water from year to year.

61) Q. Do you know the market value of stock at the North Poudre Irrigation Company for the year 1909? A. Well, I just couldn't swear, but it was in the neighborhood of $60 and probably some of it less. There isn't always that value. It is just owing to how much one farmer is willing to pay for it because of that value, it is just like buying any sheep or cattle.

Q. Are you familiar with the market value of the North Poudre Irrigation stock for 1916? A. For 1916?

Q. Yes. A. Yes, I expect I was.

Q. Can you state what that fair market value was? A. As it says here, 125, and I imagine--

Mr. Swanson: Your Honor, I object to that. Counsel is now having him read from the exhibit, which is improper. The exhibit is not in evidence.

The Court: Sustained.

Q. (By Mr. Drexler): Mr. Kluver, can you tell us where the figures that appear on Plaintiffs' Exhibit 1, for identification, came from?

Mr. Swanson: If Your Honor please, the proper way to do is to identify the document itself, then we will determine what it is made up of.

62) The Court: Yes, we don't know what this piece of paper is yet, Mr. Drexler. What is it?

Q. (By Mr. Drexler): What is this Plaintiffs' Exhibit 1? A. It is the value of stock from one year to another, each year as listed, that has been paid by the farmers for this stock.

Q. Who prepared this document? A. Who prepared this?

Q. Yes. A. Well, I don't know who did. I suppose it was Mr. Rogers got it from the Water Supply.

Mr. Swanson: I object to that. He says he doesn't know and he supposes.

A. Mr. Rogers, the Accountant, got it from Water Supply.

Q. (By Mr. Drexler): Where did he get the figures. A. From our Secretary.

The Court: I am confused now. Mr. Kluver first says he doesn't know where the figures came from. If he doesn't know, that's it.

A. They came from our Secretary for the North Poudre and the Water Supply. But whose statement this is I don't know.

Q. (By Mr. Drexler): A moment ago I believe you were reading some figures from a slip you took from your pocket. Where did you get that list? A. I got it from the auditor.

63) Q. Did you supply those figures? A. No, I did not.

Mr. Drexler: No further questions.

Cross-Examination By Mr. Garver.

Q. Mr. Kluver, have you any personal knowledge of the various prices of stock, the price paid for the stock in these two companies? A. Yes, I have.

Q. Have you yourself bought and sold any of the stock? A. No.

Q. You have not. A. Only with the land.

Q. I see. But you have bought land-- A. I have bought in North Poudre.

Q. Could you tell me just how that came about, did you buy the land and the stock altogether, or did you buy one and then the other? A. I bought land with the water rights and I

found out it was short of water and bought water from another party.

Q. Oh. So that some of that stock came right in the original purchase price? A. Of the land, that's right.

Q. And some of the other stock you bought from someone else? A. From someone else.

64) Q. Now, you have testified that you bought this stock in order to obtain water for your farm? A. Yes.

Q. Now, I wonder if you could tell me whether this stock would be more valuable to you if you could obtain the water by paying a smaller annual investment? A. More valuable to me?

The Court: Mr. Garver, the answer to that question is obvious. If I can get water for my farm by paying $500 a year less, most obviously I am going to do it. If I can buy a Ford automobile for a thousand dollars off the list price, I am going to do it. How is that material to the case here?

Mr. Garver: I thought Your Honor expressed some concern about whether the value of the stock would rise because of the payment of the indebtedness to the two corporations. I was going into this matter mostly in response to inquiries which I thought you had made at the hearing on the Motion for Summary Judgment.

The Court: Yes, but I was interested from a slightly different viewpoint, Mr. Garver. Go ahead.

Q. (By Mr. Garver): Mr. Kluver, have you ever withdrawn any of this water from the ditches of either of the companies and then, I believe the term is rented, it to someone else? A. I have from the North Poudre a number of years ago to one of my neighbors.

65) Q. Now, you also spoke during the direct examination about your renters. I am afraid I was a little confused about that. Could you tell me what you meant by your renters? A. My renters are tenants on the farms.

Q. I see. How do they get their water, do they pay you

for it? A. No, I rent the place, these farms, to these renters, which some of them have been with me from 25 to 35 years and the water goes with the farms.

Q. I see. Then the water is more or less paid for-- A. I pay for the water assessments.

Q. Now, could you tell me how much you charge for the water you rented to your neighbors, that is, the people who were not your tenants, do you recall offhand? A. I haven't rented any water to my own neighbors since, I think, '49 or '50. I believe I rented one man some North Poudre water for $25.

Q. $25? A. A share, North Poudre water. That is about what the assessments were. Another time I rented the Ideal Cement Company some water, a share of water, two years ago for one summer.

Q. Well, now, could you tell me whether you rented the water--this is water for a whole year, I take it? A. For the season, yes.

66) Q. Whether you rented the water for a greater price than you had to pay as an assessment? A. I did, the water supply.

Q. Is that the water that went to the Ideal Cement Company? A. Yes.

Q. And what about the water that went to your neighbors? A. Well, they were my neighbors, they were farmers. Ideal Cement Company owns a great deal of land in that locality. They were my neighbors. We trade back and forth.

Q. So that you didn't make a great deal of profit, at any rate, on the renting of the water to your neighbors? A. Not a great deal.

Q. Now, you say that you can also rent water. That is another way of getting water besides buying stock in these companies? A. That's right.

Q. Now, have you any personal familiarity with the prices that might be charged for renting water? A. I haven't

under the North Poudre, just what they are paying for water this year.

Q. No, I don't mean this year. A. Or in the past.

Q. I am talking about 1949 and '50. A. Under the North Poudre you pay very little more. Sometimes you are lucky to get out with what you pay on your assessments. If there is plenty of water and there is somebody that needs the water and it is in demand and you don't really need all your water, you will sometimes, oftentimes, rent it for less than your assessments.

67) Q. Well, now, what do you mean, for less than your assessments, do you rent all your water for one year? A. No, maybe rent three or four shares or four or five shares for less than your assessments. Maybe that will run along in the summer and some farmer will need it, or your neighbor, and you rent it to him as an accommodation.

Q. You would say it is possible to obtain water at a lower rate if you don't obtain it through the regular method of paying assessments on shares of stock, or it was possible during 1949 and '50? A. Well, it depends--I just can't recall the very year of '49 and '50, but there are times we have rains or one man will need to have more for a beet crop than he is willing to pay for.

Q. I see. Would you say that it might be true in any particular year the water might rent for either more or less than the assessments? A. That's right.

Q. I see. Now, you testified, I believe, that the Water Supply and Storage Company sells water to the Ideal Cement Company? A. Yes, by the barrel. It has a little meter. I think it runs, oh, I don't remember what it was last year, very little.

68) Q. As an officer and director of the Water Supply and Storage Company do you know how the price is determined? A. By the barrel.

Q. I don't mean by the barrel. A. On a meter.

Q. On a meter? A. Yes.

Q. Well, did you have any part or do you know how the

company determined what to charge per barrel or what to charge-- A. I had, but I just can't remember now. It seems to me, as I stated, the oil company, I think their water comes to possibly around $300 that they paid for water last year.

Q. The oil company? A. Yes, the oil company. We also sold some to an oil company. But the Ideal Cement Company, I just can't remember how much that was, but it wasn't much.

Q. I am not asking you for a specific figure but if you are selling water by the barrel, I suppose you must charge, say, $5 a barrel? A. Oh, no, no.

Q. I am not familiar with the prices. A. I think it was possibly a cent a barrel or a cent and a half.

69) Q. Fine. Say it is a cent a barrel. Could you tell me how you determine whether it was to be one cent or one cent and one-eighth? A. Well, they estimate by the barrel and it was finally run through the meter and I think, as I say, I just couldn't tell you what the Ideal Cement Company paid. I heard it and I read it, but to swear to it I just wouldn't be able to tell you exactly.

Q. Well, did the company, the Water Supply and Storage Company, intend to make a profit on the water sold? A. Yes, it was sold for more than we would have got out of it. We didn't need it, that is, we needed it, but as an accommodation we let them have it, that's all. We didn't have it to sell. It was just an accommodation, it was so little.

Q. I understand. You also said something about an oil company. Was this done on the same basis as the Cement Company? A. Yes.

Q. Were there any other people who bought it? A. No.

Q. Those were the only two? A. That's right.

The Court. Pardon me. Mr. Kluver, does the Water Supply and Storage have a priority right which permits it to make such sales?

70) The Witness: Well, Your Honor, Judge, I don't know as

they do, but the oil company wanted to irrigate a little yard, sprinkle a yard around Black Hollow, and the Ideal Cement Company needed very little water and we let them have it. It was satisfactory to the rest of the directors and also the stockholders.

The Court: Yes. Of course, the thing that was bothering me on your testimony was the principle that in a mutual ditch company the water really belongs to the farmers, those that put it to use; the priorities are not owned by the company.

The Witness: Of course, it was through the farmers' consent that we let them have it, brought it up at an Annual Meeting.

Q. (By Mr. Garver) Do you know of any reason why the company could not or should not have sold water to other people, other farmers? A. We didn't have it to sell for no other purpose.

Q. I mean, you did sell some? A. Yes.

Q. Do you know of any reason why you couldn't or shouldn't have sold that?

The Court: Well, now, Mr. Garver, that gets into a difficult situation. I think the Colorado Supreme Court said a good many times that the priority rights of this water are owned not by the company but by the individuals who put the water to beneficial use. So your question is a legal question, unless it can be established that for some reason which has not yet been developed the Water Supply and Storage Company as a corporate entity owns some water itself under Colorado law. I don't know whether it did or not. That is one difficulty with this case, Mr. Garver. Water is owned by the farmers and not by the company. Yet to get the water they have to use the facilities of the company.

71) Mr. Garver: Yes, I had particular reference in my last question to the sale of water to the other farmers more than industrial concerns. I realize they are classed in different priorities, and I had assumed without having, certainly, an intimate knowledge of the water priority law of Colorado, that the company acting in behalf of the farmers would be free to rent water from year to year without actually losing the right to it providing it was used on the same priority level as a person who held the permanent priority.

Q. (By Mr. Garver): Mr. Kluver, you say that the stock may be sold separate from the land, is that correct? A. That's right.

Q. So that a farmer could at any time sell the stock and possibly get his money out at any time? A. That's right.

72) The Court: Well, just a minute, Mr. Kluver. Can he do that and sell it to somebody whose land isn't subject to irrigation under the ditch?

A. No, he would have to be under the ditch, Judge. Nobody but a farmer under the ditch.

Q. (By Mr. Garver). But, at any rate, he can sell it? A. To another farmer.

Q. And it is entirely possible that he would sell it, and I suppose the situation has arisen in the past, to your knowledge, where he sold it for more than he paid for it? A. In some cases I presume he has.

Q. Have you as a member of the Board of Directors of the Water Supply and Storage Company ever given consent for the sale of any share of stock? A. The Directors are not--the shareholder doesn't have to ask the Directors.

Q. He can sell it without permission from anyone? A. He can sell it without any permission whatever.

Q. I see. Are you as familiar in detail with the affairs of the North Poudre Company as you seem to be with the Water Supply and Storage Company? A. Some, not a great deal.

Q. Would you know if they had ever sold water to someone other than stockholders? A. No, they cannot. I don't think they can, I am sure -- that I wouldn't say for sure, but I don't believe they have.

73) Q. But you don't know? A. Not positive, no.

Mr. Garver: No further questions.

Redirect Examination By Mr. Drexler.

Q. Mr. Kluver, just let me try to clear up one or two things. Can you give me an approximate idea of about how many acre feet of water a year goes through the ditches of the North Poudre and Water Supply? A. Well, let's see, the water supply, I wouldn't want to tell you exactly, no.

Q. What percentage would you say the water furnished to Ideal Cement and this oil company amounted to? A. Oh, just such a very, very little fraction. Ideal Cement could also own stock in the ditch.

Q. Were any of those minor sales made during 1949 and 1950? A. No.

Q. I believe you stated on cross-examination that you presumed that some farmers sold stock for greater than their investment. Do you know of any such case of your own knowledge? A. No, I can't tell you exactly, the exact time, but I do know that you could get more out of it, possibly, than some has paid.

Q. You mean there are no restrictions? A. No, there is no restriction.

74) Q. Tell me, would it be practical to farm with rented water? A. Yes.

Q. Do some people do that? A. Yes.

Q. Would it be practical for a land owner, a stockholder, to sell all of his stock if he stayed in farming? A. No.

Mr. Swanson: Your Honor please, I must object to this. This is purely speculation. We are talking about 1949 and 1950 in this case, and now Counsel evidently is directing his questions to the present time. Furthermore, it calls for an opinion and conclusion and speculation.

The Court: Let's go forward. This is a trial to the Court.

Q. (By Mr. Drexler): I believe you said it wouldn't be practical to sell your stock if you held on to your land? A. No.

Mr. Drexler: I believe that's all.

The Court: Mr. Kluver, if a person buys stock in Water Supply and Storage Company they do it to get water for their land, don't they?

The Witness: That's right.

The Court: And doesn't the price that they have to pay for that depend on a number of variable facts, such as the market conditions for agricultural products that might be raised at that time?

75) The Witness: Yes.

The Court. And also as to the weather conditions, the amount of water in storage, and things like that?

The Witness: Your Honor, that's right.

The Court: I have no further questions.

(Witness excused.)

Mr. Sobol: Call Mr. Munroe.

Edward F. Munroe, called as a witness on behalf of the Plaintiffs, was examined and testified as follows:

Direct Examination By Mr. Sobol.

Q. Would you state your name, please? A. Edward F. Munroe.

Q. And are you one of the Plaintiffs in this action? A. I am.

Q. Along with your wife, your wife is a Plaintiff, too? A. Yes.

Q. Where do you live, Mr. Munroe? A. Fort Collins.

Q. During 1949 and 1950 what was your business? A. Farming and livestock.

Q. Are you a stockholder in either the North Poudre Irrigation Company or the Water Supply and Storage Company? A. I am in the North Poudre.

Q. Are you an officer in the North Poudre? A. I am a director, yes.

76) Q. Did you at any time--well, when did you first buy your stock in North Poudre? A. You mean the first stock?

Q. When did you first obtain it, that is? A. The first stock I bought--of course, I bought that stock with the farm; I think that was about 1914 or '15.

Q. And is your farm located--where is it located in relation to the ditches of North Poudre? A. Well, the farm I have now and ranch is located right along the ditch.

Q. During 1949 and 1950 did you obtain water for your farm from the ditches of the North Poudre? A. I did.

Q. And did you use all the water that you obtained? A. I think I did.

Q. Used it for irrigation? A. For irrigation.

Q. Did you rent any water other than what you obtained? A. I don't think I did in those years.

Q. At any time, Mr. Munroe, did you buy stock of the North Poudre apart from land? A. Yes.

Q. Did you at my request or Mr. Drexler's make any sort of investigation to determine, to the best of your recollection, how much you paid for that stock? A. That's right, yes, I did. I think I have got it jotted down here if I didn't leave it in my other clothes.

77) Q. Would you take out your memorandum that you made in that connection?

Mr. Swanson: Your Honor please, I think Counsel first should ask the witness if he knows what he paid for it, and if he doesn't know what he paid for it, I think that's the answer. Now, unless there are some documents that he has that he can use to refresh his recollection, we don't know when something like this was made up, that is not the proper way to do it.

The Court: Objection sustained.

Q. (By Mr. Sobol): Mr. Munroe, do you know of your own knowledge what you paid for your stock in the North Poudre at various times? A. In 1919 I bought 50 shares--

Q. Mr. Munroe, do you know without looking at that paper--in other words, how was that paper made up? A. Well, they asked me--Mr. Rogers asked me if I could tell him what this stock had sold for during different years.

Q. Yes? A. Well, I went down to the office and checked up on it. Now, going over those records it don't show in the office whether you paid so much for stock, or you or this fellow (indicating). So I had always remembered this because this was pretty high-priced stock. I bought this in 1919 for $205. If you want to know the people I got it from, Murdock Nelson and Jesse Wilson in 1919.

78) Q. That is $205 for one share? A. Per share, yes. I bought 50 shares.

Q. In 1919? A. Then in 1925 I bought, I believe it was around 20 shares for $125.

Mr. Garver: I would like to object to this line of inquiry. If the witness is going to testify from the piece of paper he has in his hand I suggest that it be marked as an exhibit and offered.

The Court: Well, I don't think we are proceeding quite according to the rules of evidence. If the witness has a recollection as to these amounts he can testify. If he does not have that recollection, then the means are open for refreshing his recollection. Another way is through records and the pertinent documents involved in these transactions. Now, thus far not a one of those methods is being pursued. So the objection is obviously good.

Q. (By Mr. Sobol): Mr. Munroe, do you have an actual recollection of what you paid for various shares of stock at various times? A. Right here, yes.

Q. Now, do I understand you correctly that what you have got written down on that piece of paper is what you got from your own memory? A. Well, the $205, there is no memory about it, because in 1921 if you was feeding sheep and they bloated up the way they did you would find out you had some high-priced stock on your hands.

79) Q. But you remember that you bought stock for $205? A. That's right.

Q. And do you remember what you paid for stock at any other various dates? A. The lowest stock I bought was along in--

The Court: That wasn't the question, Mr. Munroe. The question is, do you remember what you paid for stock at various other dates? The answer to that is either Yes or No.

A. Yes.

Q. (By Mr. Sobol): What other dates would they be? A. I think the lowest stock I bought--I will always remember that, too.

Q. What date was that? A. That was sometime in '33 or '34.

Q. 1933 or '34? A. Somewhere in there.

Q. How much, do you remember--without looking at the paper do you remember how much you paid for that stock? A. Yes, $27.

80) Q. Do you remember any other dates at which you would know the price which you paid for stock? A. Around 1925.

Q. How much did you pay then? A. $125.

Q. Are those the only dates that you recall?

A. I think that's the only dates that I bought stock.

Q. So to sum up, your testimony is that in 1919 you paid $205, in 1925 you paid $125, and I believe you said in 1933 $27. I take it you are generally familiar with the affairs of the North Poudre? A. Yes.

Q. And do you know whether or not the stock of the North Poudre is customarily sold with a piece of land? A. Customarily, yes.

Q. Do you know of your own knowledge whether there has been any speculation in the stock of the North Poudre?

Mr. Swanson: Your Honor, please, this has got to be applicable to 1949 and 1950.

The Court: Objection sustained.

Q. (By Mr. Sobol): Do you know whether or not during 1949 and 1950 there was any speculation in the stock of North Poudre? A. I don't know what you mean by speculation. Every body who has got something to sell tries to always get what money he can. I wouldn't call any of this stuff speculation.

81) Q. Mr. Munroe, how long have you been a Director of the North Poudre? A. Oh, I think the first year I was a Director in 1919, I believe. From 1923 to 1952, I believe it was, I was President of the North Poudre.

Q. You are generally familiar with the affairs of the company and how things work? A. I think so.

Q. Are you generally familiar with sales of stock, that is, sales of water stock in your vicinity of the North Poudre Company? A. Well, when a man comes in to sell his stock it has got to be transferred on the books. I have signed a good many--the President and Secretary has to sign the stock certificate. In meeting people and talking to them I generally knew what it was selling for.

Q. Mr. Munroe, would you be able to express an opinion as to what factors are relevant to the price at which stock might be sold, if the stock is sold apart from the land?

Mr. Swanson: Just a moment, please. That certainly calls for an opinion of the witness which I don't think is relevant or proper in this case.

Mr. Sobol: Your Honor, I am trying to qualify Mr. Munroe as an expect in this respect. He has been a stockholder and Director since 1919.

82) Mr. Swanson: I don't see how there can be an expert on a question such as that. It is a matter of fact.

Mr. Sobol: He is generally familiar with economic conditions and what people think.

The Court: He may answer the question. Proceed.

A. Well, what enters into a lot of this stuff is, some fellow might have a poor farm and us fellows aren't very flush with money, us fellows on the farming end of it, we get hard up and we might be able to sell this water to some neighbor and raise some money that way. In other conditions there might be a piece of land that would get seepage. Another place a man might put down an irrigation well and use the water from that source and have his water available to transfer to some other piece of land. Now, under the North Poudre Ditch we have a way more land than we have water for it.

Q. (By Mr. Sobol): Would you care to express an opinion as to whether the amount of the debt of the company has any correlation? A. It doesn't seem to.

Mr. Garver: Objected to on the same ground as the previous question.

The Court: Let me understand the basis of your objection to that. I thought you were arguing, I thought it was inherent in your argument that the diminution of the debt of the company would have some sort of relationship to the value of the stock. Now, if that is your theory why isn't that question proper?

83) Mr. Garver: I think that calls for expert testimony, Your Honor.

The Court: This man, as I understood his testimony,

was President of the company from some date in 1920 to some date in 1940. It seems to me if anybody knows anything about this company he ought to know about it.

Mr. Garver: I considered a question of evaluation was a question for an expert. That is what I base the objection on.

The Court. Well, now, as to the value of real estate in Philadelphia or Washington, D. C. it might be different, but we are involved now with Weld County, Colorado, and I think that the man who was President of this Company for all the years that Mr. Munroe was is more qualified to give his opinion on the value and the factors that go into the value than would be the best and highest pric[illegible] firm of appraisers in the whole United States.

Mr. Garver: I withdraw the objection, Your Honor.

Q. (By Mr. Sobol): Do you know whether the North Poudre Company ever supplies--or during 1949 and 1950 supplied water to persons who were not stockholders? A. Well, in this way: If some stockholder rented it to some non-stockholder it was under the ditch and the water could be delivered to him.

84) Q. But the person doing the renting was the stockholder? A. He would be the stockholder. The company owns no stock. They own a little stock but I mean the stock itself, the 10,000 shares of stock in this company, it is all outstanding; then a few years ago I think the company bought back 25 or 30 shares which they just rent out to some stockholder.

Q. Do you know whether during 1949 to 1950 the North Poudre Company carried water other than that obtained by its own appropriations and decrees? A. No, they didn't. They didn't carry any water. They haven't any to carry for anybody else.

Q. Is it necessary to obtain the consent of the Board of Directors before the stock of the North Poudre may be sold? A. No.

Q. What was your purpose in buying the stock of North Poudre? You testified you bought it in 1919, 1925 and 1933. A. The intention was, I have a ranch up there, a livestock ranch, and there was a lot of that land could have been irrigated and still could be irrigated, and that was my intention at that time,

was to put that land under cultivation, which I have never done.

Q. Do you know whether during 1949 and 1950 the water of North Poudre was used for anything other than farming? A. Total? No, that is all it was used for.

85) Q. From your general familiarity with the affairs of the company could you state whether there is a ready market for the stock of North Poudre apart from the land? A. Oh, it would be probably in a very limited way.

Q. Do you know whether during 1949 and '50 most of-- well, do you know whether or not the stockholders used the water which they obtained during '49 and '50? A. Used their water?

Q. Yes.

The Court: That is a pretty general question. I think you can ask that to Mr. Munroe as to whether he did, but I feel certain with the generalities you had in it if he answered the question in many instances it would just be on hearsay.

Mr. Sobol: I withdraw the question.

Q. (By Mr. Sobol): Mr. Munroe, would you know of your own knowledge the approximate indebtedness of the North Poudre Company in 1919? A. In 1919 it was somewhere around--might be a little off on it, but around $550,000.

Q. Would you know of your own knowledge the approximate indebtedness of the company in 1925? A. Just about the same.

Q. And in 1933? A. In 1933 it was about the same. In 1936 or '37 we refinanced for $610,000.

86) Mr. Sobol: Thank you, Mr. Munroe.

Cross-Examination By Mr. Garver.

Q. Mr. Munroe, as Director in the North Poudre Irrigation Company, do you have any voice in determining how much the assessments should be for each year? A. Well, the Board of Directors, we make up a budget and recommend to the stockholders for their approval and it is usually approved from the recommen-

dation of the Board of Directors.

Q. I see. And have you been at Directors' Meetings and are you able to state what factors are considered in recommending a certain assessment? A. I attend the Stockholders' Meeting.

Q. No, I am speaking about the Board of Directors' Meeting. Are you a Director of North Poudre? A. I am.

Q. Do you attend the Directors' Meetings? A. I do.

Q. Have you been at meetings where a recommendation as to the amount of an assessment was prepared? A. I have.

Q. Have you heard what different factors had to be considered? A. I have.

Q. Would you say that the Board of Directors could recommend a lower assessment if the bonded indebtedness were paid off? A. Well, that would depend a whole lot. Supposing we had a bad ditch break.

87) Q. I am assuming all other factors were the same as they were in 1949 and '50. A. Well, if we didn't--that would be pretty hard to say. We ought to be able to levy a little lower assessment.

Q. In that manner the companies would be able to supply water at a cheaper assessment rate? A. Well, from that one point of view, but there is a lot comes into it besides just that.

Q. Oh, yes, I understand. Now, would you say that one other factor in determining how much the assessment should be is the amount of income other than from assessments which the company has? A. Well, our income is very limited.

Q. Well, now, do you have any income from oil and gas? A. We have a little, yes. Mostly through rentals, rental of land.

Q. I see.

Mr. Sobol: I will ask Counsel to confine this to '49 and '50.

Q. (By Mr. Garver): Did you have any income in 1949 and 1950 from oil and gas? A. Leases? A little oil and gas? Yes.

Q. In 1949 and 1950 did you also have income from water rentals? You testified previously, I believe, that the company bought 20 shares of stock and now rents that water. A. It was probably rented, yes, I would imagine so.

88) Q. In 1949 and '50 did the company own or lease any office space which in turn they leased to someone else?

Mr. Drexler: If the Court please, I might just say in the interest of conserving time that the detailed Annual Report of these companies for 1949 and '50 showing sources and amounts of income is in evidence, has been signed and is in evidence.

Mr. Garver: May that be treated as already in evidence without being reoffered, Your Honor?

The Court: Well, so far as I know it isn't in evidence. There has been a stipulation here but that hasn't been offered. There are a lot of exhibits here but none of them have been offered. As far as I am concerned, there isn't anything in evidence except oral testimony.

Q. (By Mr. Garver) Do you know whether in 1949 and '50 the North Poudre Company rented any lots? A. Yes.

Q. And do you know whether in 1949 and '50 the North Poudre Company received any money as interest on money owing to that company? A. Money owed to that company?

Q. Yes. A. Well, the only money--the only way there would be any money owed to the company is some fellow who hasn't paid his assessment. While he is in default in his assessment of course they charge him 8 percent interest. So there would be some revenue there.

89) Q. Now, do you know whether during these years the North Poudre Company rented any office space? A. Yes.

Q. I mean rented to someone else. A. That's right.

Q. And they received money for that? A. Yes.

Q. Now, would you say that if the income from these various sources was either higher or lower, that the assessments would have to be either lower or higher? A. I don't think that the income, the income that the North Poudre has, would have any effect. It isn't large enough to have any effect on the assessment.

Q. I see. You have testified that you have been associated with the North Poudre Company since 1914 or 1915? A. 1919.

Q. 1919, excuse me. At one time did the North Poudre Company receive substantially more money from oil and gas sources than they did in 1949 and '50? A. Yes.

Q. Now,were you Director of that--could you tell me when that was, first? A. Well, that was along about--that must have been--I think that discovery well come in along about 1925 or '26, and it would be between '25 and '30, between the years '25 and '30.

90) Mr. Sobol: I will object to this line of questioning on the ground it is irrelevant.

The Court: It is pretty remote, Mr. Garver. What is its relevance here?

Mr. Garver: Well, I had hoped to establish that as this company used money for capital purposes, that it would be possible and probable that the assessments would be lower, and therefore that the company could supply water at a lower rate.

The Court: Well, I think that the testimony and the evidence should bear some close relationship to the date involved here. On the examination of the other witness and the direct examination of this witness, the Government objected on the ground that the questions were too general, weren't tied down to the specific years, and I sustained some of the objections. What goes for one side goes for the other. Objection sustained.

Q. (By Mr. Garver): If the income of the North Poudre Company from the various sources that I have mentioned had been considerably greater during 1949 and 1950 would you have recommended that a lower assessment be made than was made?

Mr. Sobol: I object to that.

91) The Court: Sustained.

Q. (By Mr. Garver): Mr. Munroe, you testifed on direct examination that the consent of the Board of Directors was not necessary in order to sell the stock. Is anyone's consent necessary? A. Only the buyer and seller. If they get together, that is all that is necessary.

Q. Have you rented water that you received from the North Poudre Company to other people? A. You mean this stock that the North Poudre owns themselves?

Q. No, I am talking about water you got from the company. Did you ever rent it out to someone else? A. Oh, I have rented out a little once in a while.

Q. Did you generally charge more or less than the assessment of the company? A. Well, that depends on the demand. In some years you might get more, another year less.

Mr. Garver: No further questions.

The Court: Any redirect?

Redirect Examination By Mr. Sobol.

Q. You were asked on cross-examination, Mr. Munroe, about the various factors which the Directors consider in making an assessment. Would you state whether you, in addition, give any consideration to the fact, if it is a fact, that reservoirs silt up and the structures like concrete structures wear out? A. Why, sure. We take that into consideration in making up our budget. I think we have spent this year--that is in 1949 and '50, but I think this year we are putting in riprapping that I think is going to run fifteen or twenty thousand dollars.

92) Q. Do you consider what it will cost to replace that when it finally wears out? A. No. No, we haven't taken that into consideration, but in levying our assessment for 1946 for doing this work we have to take that into consideration.

Mr. Swanson: Again I have to object to this. He is

talking about 1946 now.

The Court: Yes. Sustained.

A. But the same thing applied from '49 to '50.

Q. (By Mr. Sobol): You testified on direct examination about your purpose in buying stock. In connection with that could you tell me if the company were to split up, would the ditch be any good to you?

Mr. Swanson: Well, Your Honor, I must object to that.

The Court: Sustained.

Mr. Sobol: I have no further questions.

The Court: Mr. Munroe, the lawyers in this case have entered into a stipulation which hasn't been offered yet as part of the record here. It is stated in there that you and your wife in 1949 paid an assessment of $11 a share and the Government disallowed $4.45 of that. Now, the difference between that $4.45 and the $11 is $6.55. For the next year the stipulation shows the assessment at $12 a share and a disallowance of $4.60. The difference there is $7.40. If you had tendered the North Poudre Company $6.55 in 1949 and $7.40 in 1950 as your payment per share, would you or would you not have gotten any water?

93) The Witness: I wouldn't have gotten any water.

The Court: That's all.

Mr. Drexler: Your Honor, with the permission of Counsel for the Government I would like to offer the Stipulation and attached exhibits in evidence at this point.

The Court: Well, now, are these all marked? Did anybody check them?

Mr. Drexler: I believe at the time they were tendered they were in order.

The Court: The trouble is, we have a piece of paper that says "Stipulation". Then we have a mass of material here and I

don't know whether it is all here or whether it isn't. I think we will take a recess at this time and I wish the parties would check the exhibits which have been referred to here and if they are not marked have them marked for identification so that the first thing in the morning the offer of Mr. Drexler can be considered and in the morning we will have to call the Civil Calendar first, but I think that will not take very long. This case will go over until 9:30 tomorrow morning.

* * * * *

95) The Court: You may proceed in Civil Action 4710, Akin against the United States.

Mr. Drexler: If the Court please, at this time I would like to offer the Stipulation signed by the parties, together with a number of attached exhibits, and would the Court prefer that I offer each exhibit separately? They have been marked.

The Court: Well, let me ask the Government. Mr. Garver, Mr. Drexler is offering the Stipulation and the attached exhibits. It seems to me since they are in effect a part of the Stipulation there is no need to re-mark them. They are referred to in the Stipulation. Is there any objection to that?

Mr. Garver: No objection.

The Court: We will receive the Stipulation and the attached exhibits. They are all part of the evidence.

Mr. Drexler: I will call Mr. Akin.

Victor H. Akin, called as a witness on behalf of the Plaintiffs, was examined and testified as follows:

Direct Examination By Mr. Drexler.

Q. Would you state your name, please? A. Victor H. Akin.

Q. How do you spell that, A-k-i-n? A. Yes.

96) Q. Where do you live, Mr. Akin? A. I live about 8 miles northeast of Fort Collins on the farm.

Q. Are you and your wife among the plaintiffs in this case now on trial? A. We are.

Q. What is your occupation, Mr. Akin? A. Farmer and feeding and raising livestock.

Q. Were you engaged in that occupation during the years 1949 and 1950? A. I was.

Q. Were you during those years a stockholder in either the North Poudre Irrigation Company or the Water Supply and Storage Company? A. In each.

Q. How long have you been a stockholder in each? A. I became a stockholder in 1907. I have a record but I became-- three years before that I was a minor and my father had the stock.

Q. In which company is that? A. That is Water Supply.

Q. That was the Water Supply. Do you know how long your father had been a stockholder before you there? A. On this piece of land?

Q. Yes. A. He was a stockholder from '98 on.

97) Q. From 1898? A. On the particular stock I got he was for three years before--that would be 1904 on this stock I had.

Q. When did you first become a stockholder in North Poudre? A. Well, it was around the twenties.

Q. How did you acquire your original stock in the North Poudre? A. Well, the first stock I got was with some land.

Q. That was in the twenties? A. Yes.

Q. Have you been an officer or director of either company? A. I have been a director in the North Poudre and am now. I was a director for 25 years out of the past 30. From '46 there was four years to '50 that I wasn't a director.

Q. For what purpose did you acquire your stock in these companies, Mr. Akin? A. To furnish water to raise crops.

Q. During 1949 and 1950 did you use all of the water which you obtained from these ditches? A. Yes.

Q. For what purpose did you use the water? A. To raise a crop.

Q. Did you use any additional water for irrigation besides that which was furnished to you on your stock? A. I did.

Q. Where did you obtain that water? A. Well, I obtained 140 shares from the Updyke Agency, Greeley, and there was just a small amount from another stockholder there as Secretary of the North Poudre office.

98) Q. Did I understand you to say the Updyke Agency is a stockholder in North Poudre? A. They were. They represented the Colorado Investment Company which had loaned a lot of money out in the North Poudre area and a lot of the land wasn't paying for the renting and they just separated, abandoned the land, and were using the water rental to try to pay the expenses.

Q. Mr. Akin, what was the amount of the assessment which you paid to North Poudre in the years 1949 to 1950? A. It was $12 each year.

Q. Do you know what you paid for the water which you rented? A. I do.

Q. How much was that? A. It was $14 a share.

Q. Do you have any evidence of the amount of the rental? A. I have cancelled checks in my pocket with notations on the corner what they were and the endorsements of the people I dealt with.

Q. May I see those checks please? A. That is 1949, also (handing documents to Counsel.)

(Plaintiffs' Exhibit No. 2 marked for identification.)

Q. (By Mr. Drexler): Mr. Akin, I hand you Plaintiffs'

exhibit 2, for identification, and I will ask you what those checks represent? A. Those checks represent the payments for the assessments in the North Poudre Irrigation Company and the Water Supply and Storage Company, and also checks for the rental of extra stock for the years 1949 and '50.

99) Q. Don't you mean extra water rather than stock? A. I have to rent the stock to get the water.

Q. Very good. Mr. Akin, would you refer to the check regarding which you have testified, paid to the Updyke Agency and state whether or not it bears any notations? A. It does.

Q. What is that notation? A. This check is for $1960 for 140 shares of water. It says--on the notation it says "140 shares of North Poudre water stock for 1950 season." Then for the '49--you want both?

Q. Let me have a moment.

Mr. Drexler: I would like to offer these in evidence, Your Honor.

The Court: Any objection to Plaintiffs' Exhibit 2?

Mr. Garver: No objection.

The Court: There being no objection, Plaintiffs' Exhibit 2 is received in evidence.

(Plaintiff's Exhibit No. 2, for identification, was received in evidence.)

100) Q. (By Mr. Drexler) Mr. Akin, just to explain the amounts on the Plaintiffs' Exhibit 2, did you pay the assessments for 1949 and 1950 in one or more than one installment? A. Well, they are paid in two installments. That is the way they collected a certain amount due April 1st and a certain amount October 1st, and after that date if they are not paid an 8 per cent charge of interest is made for whatever I haven't paid.

Q. The checks which you drew for rental of additional stock and water, are those checks for an entire year, is each check for rental for an entire year? A. From the person that I rented this water, because there was another check for $20 after this 140 shares, I think, that I rented, and then there was Water Supply and Storage that I rented by the day as stockholder for two different periods, two days each.

Q. Mr. Akin, did you ever sell or purchase any shares of stock of North Poudre or Water Supply Company separate from the land? A. You said did I sell or purchase?

Q. Yes. A. I have never sold any but I have purchased extra water from the North Poudre stock.

Q. Do you know on what dates your purchased any such stock? A. In 1934 I purchased 115 shares of A. F. Moore and gave him a note of $9000 for the purchase of these 115 shares.

101) Q. How much per share? A. That represents $78.26, I believe.

(Plaintiffs' Exhibit No. 3, marked for identification.)

Q. (By Mr. Drexler): Mr. Akin, I hand you a document which has been marked Plaintiffs' Exhibit 3, for identification, and ask you to state what that is. A. That is a note given--a note signed by me, and the amount is for $9000 and the notation on this note says "Cert. No. 3790 for 100 shares and Cert. No. 3800 for 15 shares of the North Poudre Irrigation Company."

Q. Is that note marked "Paid"? A. It is marked "Cancalled".

Mr. Drexler: I offer Plaintiffs' Exhibit 3 in evidence.

The Court: Any objection to Plaintiffs' Exhibit 3?

Mr. Garver: No objection.

The Court: Very well. Exhibit 3 is received.

(Plaintiffs' Exhibit No. 3, for identification, received in evidence.)

Q. (By Mr. Drexler) Mr. Akin, how long have you owned land and farmed along the North Poudre and Water Supply ditches? A. Farmed on my own?

Q. Yes. A. I have been on my farm all my life. Before I was old enough to go out for myself I worked for my father there, but I have been farming there ever since 1902.

102) Q. When stock changes hands, of the North Poudre or the Water Supply Company with or without land, are you usually familiar with such changes of ownership? A. Yes.

Q. The price at which stock is sold, is it a matter of general knowledge and comment? A. No, it is just a deal between whoever wants to sell and the purchaser.

Q. Are you familiar with the factors which are important in determining the price at which stock changes hands? A. Yes.

Q. What, in your opinion, Mr. Akin, are the most important factors influencing the value of stock in either the North Poudre or the Water Supply Company?

Mr. Swanson. Just a moment. Your Honor, the Government objects to the showing of custom and usage in this case, which should be confined to specific facts, individual cases as they might bear upon the issues here.

The Court. Well, now, Mr. Swanson, ordinarily I think that would be a good objection. But here is the thing that bothers me in this case. It is the Government's contention that part of this assessment is a capital outlay. It is a contribution to capital. Now, if it is a contribution to capital, what does the person who makes that contribution get? Ordinarily when you make a capital outlay you have something that you can dispose of that has some value. Now, I think one of the queries here is whether or not these stockholders under these two ditches, when they make a contribution to capital, if they have anything that they can sell. As I understand the Colorado law, the water rights are owned by those who put them to beneficial use; they are not owned by the mutual ditch companies. That being true, when you make a contribution to capital, what does the farmer get? That being an issue in the case, I think that a discussion of what makes up the value

of a share in either company is pertinent.

103) Mr. Swanson: I am not disputing that a bit, Your Honor. What I was going into, Your Honor, was the question of showing custom and usage here rather than individual cases. You only descend to custom and usage where that might become material where you can't confine it to the individual matter.

Mr. Drexler: If the Court please, I am asking for an opinion of the witness who has been a director of the North Poudre for 25 years. He has farmed the land along the ditch all of his life. He ought to be familiar--

The Court: I tell you, Mr. Drexler, if you ask this witness's opinion I am going to let him state it. I think Mr. Swanson may have a point on custom and usage, but I think this witness would be qualified to give his opinion on that.

Mr. Drexler: Would you read the question, please?

(Last question read by the Reporter.)

104) Mr. Swanson: Your Honor, I object to the form of that question. It should be tied down to the years in question.

The Court: Why should it be tied to the years in question, Mr. Swanson, when the Government says that part of this assessment goes to a contribution to capital, an outlay for capital? Now, if that is true, what do these farmers get? It seems to me that when you make a contribution to capital or make a capital outlay you should have something tangible that you can sell, that you can dispose of. To me, that is a capital asset. Now here I think from the standpoint of the law it is doubtful whether or not a farmer gets a value they can sell and dispose of. That being true, why aren't the factors that go into the value of stock pertinent, whether they are in '48 or '51 or '47 or '52?

Mr. Swanson: That may well be, Your Honor, but I have just a little difficulty in making a decision as to whether matters occurring during the year 1955 or 1956 would have any bearing upon the situation as it occurred with respect to these particular taxpayers in 1949 and 1950. Now, perhaps what might have gone on before might shed some light on it, but what since I just

don't see it, sir.

The Court: I am willing to hear argument on that. If the Government has some legal theory whereby they can show me that when a farmer makes a payment that is not for operation and maintenance but is rather a contribution to capital, according to your theory, and he gets something he can dispose of, I will sustain the objection. If you can't show me that, I am going to let it in. Does the farmer who pays the assessment get anything that he can treat as a capital asset, like a building or a piece of machinery or an automobile or a truck? Does he get something that he can sell?

105) Mr. Swanson: Perhaps I haven't made myself clear, Your Honor. What I was getting at is, in connection with the particular matter we are now trying, which has to do with the taxes of two people or a group of people here for the years 1949 and 1950, are we trying here the entire setup of these two irrigation companies or are we trying the matter of the taxes of these two people for the years '49 and '50 as it pertains to this mutual ditch company stock? That is where I have the difficulty in seeing the admissibility of the evidence.

Mr. Drexler: Perhaps I can meet Mr. Swanson's objection by asking one preliminary question.

Q. (By Mr. Drexler): Mr. Akin, was there anything peculiar to the years 1949 or 1950 with respect to the factors governing the valuation of the stock, in your opinion, which did not obtain in prior years or hasn't obtained since? A. Well, nearly every year since I have farmed there has been different conditions and different values of water to be applied to raise crops because of the difference in prices I was getting for them.

106) Q. I appreciate those were different, but was the influence of a particular type of factor, would it be the same for these two years as it would be in other years, for example, drouth? A. Well, what applied to these two years would apply to all years that I had farmed prior to these two years.

Q. Well, then, if you will, please tell me what it is, in your opinion, which determines the market value of the stock? A. We have had a very big variance in our price of beets, prices of all commodities which we raise, maybe one year, like '29, we

got $8 for beets in '30 where we had gotten six and a half in '29. So if I can raise a crop of beets that are worth $8 a ton instead of $6 a ton, I can afford to pay a little more money for rental water if I am short, to purchase it if I have the money to do it. It is the price that I am receiving for what I raise by the use of this water that determines the value of it to me or anybody else.

The Court: Well, is this a fair statement, Mr. Akin: You buy or rent water to raise crops; you buy or rent these shares in order to get water to raise crops, isn't that right?

The Witness: Yes.

The Court: And what you are able to pay or willing to pay depends on what you can get for your crops?

The Witness: Yes.

Q. (By Mr. Drexler): Is the bonded indebtedness of the ditch company-- A. I didn't get that.

107) Q. Is the amount of long-term indebtedness which the ditch company may owe at any particular time in your opinion a factor in determining the price of the stock? A. It is not.

Q. Mr. Akin, does that apply equally to North Poudre and Water Supply? A. It does.

Q. When you paid your assessments to these two companies in 1949 and 1950, Mr. Akin, can you tell me what your intent was in making those payments? A. To get the necessary water to pay my expenses and try to have a profit left in the raising of the crops.

Q. Did you intend to make any contribution to the capital of those two corporations? A. I did not.

Mr. Swanson: If Your Honor pleases, isn't that a question which must follow from the assessments that are made by the company? As I understand this evidence here, these people pay what the ditch company requires them to pay, which is the ordinary thing.

The Court: I think that's right, Mr. Swanson. I will let the answer stand. I think that's right. You pay the assessment so you can get the water, don't you?

The Witness: Yes, sir, and if I don't pay my assessments I don't get the water and I don't get a crop.

108) Q. (By Mr. Drexler): Were you present, Mr. Akin, at the Directors' meetings of North Poudre in 1949 and 1950 in which the amount of the assessment for those two years was determined? A. I was.

Q. Can you tell me whether in determining the amount of the assessment any consideration was given to the fact, if it is a fact, that the reservoirs are silting up and the concrete structures are deteriorating? A. Yes, sir. There is a variance in the maintenance cost from year to year and different things, and you have breakages in ditches and a lot of other hazards that make a variance and there is hardly any year that is the same.

Q. Does the North Poudre maintain any reserve to take care of ultimate replacement of structures and reservoirs? A. No, sir, they make an assessment to meet the expenses of that year, each year, at their annual meeting.

Q. Is the same true, if you know, of Water Supply? A. It is.

Q. And was during these years, during 1949 and 1950? A. Was there what?

Q. Was the same true of Water Supply in these years before the Court here? A. Yes.

Q. Mr. Akin, are you familiar with how the bonded indebtedness of either North Poudre or Water Supply Company was incurred. A. Yes, sir, I was on the Board of the North Poudre when the bonded debt was made, this last one.

109) Q. What was the last bonded indebtedness incurred for? A. It was incurred to take up the indebtedness that had preceded it.

Q. And was that previous indebtedness the first bonded

indebtedness? A. No, there had been another before that.

Q. Do you know approximately how many refinancings there had been in North Poudre? A. Well, I don't know. I couldn't say before 1919, but before the period, about 1920, there was no long-time loans, only short-term loans and the shorter-time loans, and they were made and commission paid out, and after that period when the first bond issue was made, it was handled in a different way and this last bond issue was an amortized bond issue which was paying off part of the indebtedness as we went along.

Q. Do you know whether any interest was, so to speak, capitalized in any of those refinancings? A. There was.

Q. Are they always able to repair or to raise enough money by assessments to repair a ditch that goes out or to meet all maintenance expenses in the year for which the assessment is made? A. No. Things have happened and they have happened with us in the past where we would have to go and borrow extra money to take care of these emergencies that have come on, breakages of ditches or breakage of the structure or collapsing or something. There is always some unforeseen event happens.

110) Q. Do you know whether any part of the indebtedness of either company represents expenditures which were made for repairs? A. Well, a very big portion of it.

Mr. Drexler: You may examine.

Cross-Examination By Mr. Garver.

Q. Mr. Akin, you testified on direct examination that you purchased, or, rather, you rented some water from the Updyke Agency. I would like you to tell me a little more, if you know, how the Updyke Agency got their stock. A. Well, as I stated, the Updyke Agency represented the Colorado Investment Company of Colorado Springs, of which Mr. Wright was President. Their business was loaning money on different farms and they had a number of farms throughout the North Poudre district that they had loaned money on and it came bad times through '30 and the loans they weren't paying off. They had too much money loaned on them and they abandoned several, a number--I don't know, several of these farms. So as to get some income they rented the water and didn't farm their land.

Q. I see. But what was the Updyke Agency, was that a collection agency or what? A. No, the Updyke Agency was the agency that looked after these loans and these farms that the Colorado Investment Company had made and had foreclosed on and he also had some interests of his own.

111) Q. In your opinion, could the Updyke Agency have sold this stock prior to 1949 and '50, or was it necessary-- A. No, they couldn't sell it then. During these years that they were holding this stock, in order to get anything at all on it they were renting it for just the assessments, to not have to raise extra cash to take care of it.

Q. What was the reason that they couldn't sell the stock, was there a restriction on it or what? A. Because of the price of crops and the amount of water that was available that a farmer couldn't go on the places which they had rented their land on and make money and they got a very undesirable class of farmers because of that fact.

Q. Well, do you mean, then, that they couldn't sell it at as high a price as they wanted to or there was some reason why they couldn't sell it at all?

Mr. Sobol: Your Honor, it seems to me that what Mr. Akin is testifying is not as to his opinion but as to perhaps what was in the intent of the Updyke Agency. I don't think he is competent to testify as to what they had in their mind or why they coulan't sell their stocks. I don't believe he really knows.

112) The Court: I cannot see how it is material to the case. They were undoubtedly considered a valuable asset. Objection sustained.

Q. (By Mr. Garver): Mr. Akin, just a moment ago you said that the Updyke Agency would rent the water for just what the assessment was, and yet I believe on direct examination you stated that the assesssment for 1949 and '50 was $12 and that you rented the water from the Updyke Agency for $14. A. Well, you didn't ask me if that just applied to those two years, did you?

Q. Oh, I see. But for 1949 and '50 they rented it, then, at a higher price than the assessment? A. At a higher price? Well, the water probably was worth $125 a share and they go

$2 more for the water than I paid for it and it is very much cheaper to rent the water than it was to own it, and it has been that fact clear up in all the time I operated until 1950.

Q. Now, Mr. Akin, on direct examination you testified as to what factors in your opinion determined the price at which stock in these water companies sold. The only factor that I recall your having mentioned was the price of the crops. In your opinion, would the amount of available water have anything to do with the price of the stock? A. The purchase price for stock?

113) Q. Purchase price. A. There is no two years that the water is the same amount. It is a variable amount of water. There is 10,000 shares in the North Poudre and whatever water is available that year is apportioned out in 10,000 share lots and there is every year a variance.

Q. I understand that, but would the variance in the amount of water available have anything to do with the price at which the stock was sold? A. In a case where a man has a farm where he has to have the water to take care of it, he has got to have that stock to protect himself, to be able to operate, and it doesn't vary much that way. But the price you receive from your crops is going to determine what a man can pay for this water.

Q. I am not sure I got your answer. Was your answer that the amount of water available does not affect the price at which the stock is sold?

The Court: Mr. Garver, how is that material here when the company does not own the water rights? If the company owned the water rights I think that would be different, but as I understand Colorado law, and you can correct me if you have some law to the contrary, the priorities, the appropriations, are in the equitable ownership of the farmers that put the water to use. Now, that being true, how is your question material here? If I am wrong, I am glad to stand corrected.

114) Mr. Garver: I certainly don't have any thought to the contrary, Your Honor, but I was attempting to show that there were other factors, and although this particular factor I am mentioning might not affect the case, some of the other factors which I hope to mention--

The Court: All right, let's get those in. But as long as your company does not own the water rights but they are owned by the people that put the water to use, how is the availability of water material here?

Mr. Garver: I am not sure it is material other than to challenge the competency of his expert testimony.

The Court: I think if you are going to challenge Mr. Akin's testimony you should practice law in some irrigated area for about ten years. That is the only comment I have on that.

Q. (By Mr. Garver): Mr. Akin, during 1949 or '50 did the North Poudre Company purchase a right-of-way in which to carry water? A. They purchased--I don't know. I am not sure of the years. They purchased for a period since that time a right-of-way.

Q. What was the purpose of this purchase? A. Of course, there is a variance in your right-of-ways.

Mr. Sobol: Just a minute, Mr. Akin. The witness has stated he is not sure whether this right-of-way was purchased during 1949 and '50, and therefore I object to any questions as to the purpose because I don't think they are about the years in question.

115) The Court: No, they can go into that if they want to. Of course, the problem that bothers me on that, Mr. Garver, on some of these rights-of-way you get a fee and some of them you get an easement. If you only get an easement, what is the value as a capital asset of one of these ditch companies? Proceed.

A. There have been rights-of-way acquired all through the years for ditches and for the reservoirs requiring them all along.

Q. (By Mr. Garver): Well, would the right-of-way make the water more readily available to the stockholders? A. If there was a new reservoir made during--just prior to this period they put in another, I think around 4000 acre-feet more storage, with a right-of-way purchase for that reservoir. This reservoir was made to have more water available to take care of your crops

through the seasons following.

Q. And that would make more water available, the purchase of the right-of-way and reservoir? A. It would make a place to have more water if the water was available.

Q. In your opinion, would the fact that there was a place for more water available and the company had a greater capacity for storage affect the price of the stock?

The Court: Oh, Mr. Garver, there is a difference between direct flow water and storage water. It won't do them any good to have a place to store water unless they have storage rights. Now, the appropriation rights are owned by the farmer. Do you know the difference between a direct flow right and a storage right?

116) Mr. Garver: No, I don't, Your Honor.

The Court: Well, I don't think your line of interrogation, then, is of much value to the Court.

Mr. Garver: That's all.

Mr. Drexler: That's all.

Mr. Sobol: Call Mr. Rogers.

H. W. Rogers, called as a witness in behalf of the plaintiffs being first duly sworn, was examined and testified as follows:

Direct Examination By Mr. Sobol.

Q. Would you state your name, please? A. H. W. Rogers.

Q. What is your occupation, Mr. Rogers? A. Certified Public Accountant.

Q. How long have you been so engaged? A. Since 1946.

Q. Have you been the Certified Public Accountant for the North Poudre and the Water Storage Supply Company? A. Yes, sir.

Q. Are you generally familiar with their affairs? A. Yes, sir.

117) Q. In connection with this case at my request did you look at the books of the North Poudre Irrigation Company to determine the amount of the long term indebtedness as of certain dates? A. Yes, sir.

Q. Did you make a note of what you found out? A. Yes, sir.

Q. Do you have it with you? A. Yes.

Q. Mr. Rogers, I believe you were here in the courtroom when Mr. Munroe testified that he purchased stock in the year 1919 for a certain price. Could you state what the long term indebtedness of the North Poudre Company was as of 1919? A. $438,000.

Mr. Swanson: Just a moment, Your Honor. I withdraw it.

Q. Could you state what your investigation of the books of the company showed the long-term indebtedness to be as of 1925? A. $588,000.

Q. Could you state what your investigation of the books showed the long-term indebtedness of the North Poudre to be as of 1933? A. $495,500.00.

Q. For 1934, for the North Poudre, would you have any idea what the long-term indebtedness was for that year? A. As I recall, it would be about the same as it was in 1933.

Q. But you did not, however, make a note of that? A. No.

118) Q. Mr. Rogers, in connection with this case did you examine the Revenue Agent's report prepared by the Government agent? A. I have seen it, yes.

Q. I hand you Joint Exhibit AA-12, which is the Annual Audit Report for the North Poudre Irrigation Company for the years 1949 and 1950. Did you prepare that report, Mr. Rogers--or reports, excuse me? A. Yes, sir.

Q. Do those reports show therein how the money, or, rather, how the income of the North Poudre Irrigation Company was spent? A. Yes, sir.

Q. Was any amount spent during 1949 for the purchase of a right-of-way? A. No, sir.

Q. Are you familiar with the assessment made by the North Poudre in 1949? A. Yes, sir.

Q. Did that assessment make an allocation for the purchase of a right-of-way? A. Not for 1949, no.

Q. For 1950 did the assessment make an allocation for the purchase of a right-of-way? A. Excuse me, for 1949 there was an assessment for the right-of-way made, and for 1950 there was one made, too.

119) Q. Now, Mr. Rogers, in the report made by the Government Agent who assessed the deficiency in this case, did he disallow that portion of the assessment which was allocated to purchase of a right-of-way?

Mr. Swanson: Please, I can't follow this method of interrogation. The witness has been handed a document which he is utilizing in giving his answers. We are now referring to some other document which is not in evidence which itself would be the best evidence.

The Court: Objection sustained.

Q. Mr. Rogers, during 1950 was there an assessment for the purchase of a right-of-way? A. Yes, sir.

Q. And was the money so spent?

Mr. Swanson: Again, Your Honor, if the witness has some knowledge of this matter it is a different thing, but to refer to a report which he has been handed which is not in evidence

The Court: Objection sustained.

Mr. Sobol: The report is in evidence, sir. I am merely trying to bring out what is in the report. He prepared the report and it is in evidence in the joint exhibit.

Mr. Swanson: I see. Has the exhibit been offered and received?

Mr. Sobol: Yes, sir.

120) The Court: I don't know now helpful it is to talk about a right-of-way until you know what kind of right-of-way it is. Just to talk about a right-of-way doesn't help me any to know whether they spent some money on a capital asset.

Mr. Sobol: Your Honor, I am trying to show the money wasn't actually spent. The agent went in and disallowed portions in accordance with the allocations made in the minutes, but actually the money wasn't so spent in all cases.

The Court: Well, do the exhibits which are in evidence show that?

Mr. Sobol: Yes, sir, they do.

The Court: Why is it necessary to have the testimony on it?

Mr. Sobol: It is not. I am just trying to bring it out. I will withdraw that.

The Court: Do those exhibits show what type of right of way it is, whether fee or easement?

Mr. Sobol: No, sir, they do not.

The Court: It doesn't help any, then, because a terminal fee for a ditch is one thing, a fee title to some ground is another thing.

Q. (By Mr. Sobol): Mr. Rogers, would you know what type of right-of-way? A. No, sir.

Q. Mr. Rogers, are you generally familiar with the refinancing of both of these companies? A. Not entirely, no, sir.

121) Q. Would you be able to state whether any of these refinancings constitute money which was spent for ordinary operating expenses from year to year? A. No, sir.

Mr. Sobol: You may examine.

Cross-Examination By Mr. Swanson.

Q. Mr. Rogers, you have given us some information here regarding the bonded indebtedness. Did that bonded indebtedness go down after the year 1934? A. Yes, sir.

Q. How far down did it go by the year 1950? A. On December 31, 1950, it was $210,500.

Q. Now, may I ask, sir, what was the total assets of the North Poudre as of the end of 1950? A $3,282,023.26.

Q. Would you give me that figure again, please? A. $3,282,023.26.

Q. Now, was there included in there some capital assets in the form of machinery and equipment, buildings, or anything of that nature? A. Yes, sir.

Q. Is that included in the Joint Exhibit AA-12? A. Yes, sir.

122) Q. Now, is it also true that included in that exhibit are the assets and liabilities of the Water Supply Company as of, for example, December 31, 1950, or is that a different exhibit? A. That is marked Exhibit BB-13.

Mr. Swanson: May I ask counsel, is Exhibit BB-13 considered to be in evidence?

Mr. Drexler: Yes, that is one of the joint exhibits attached to the stipulation.

Mr. Swanson: I have no further questions along that line.

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The Court: Any further questions of Mr. Rogers?

Mr. Sobol: No further questions.

Mr. Drexler: Mr. Barnes.

Fred J. Barnes, called as a witness in behalf of the plaintiffs, was examined and testified as follows:

Direct Examination By Mr. Drexler.

Q. Will you state your name, Mr. Barnes? A. Fred J. Barnes.

Q. Where do you reside, Mr. Barnes? A. Fort Collins.

Q. What is your address? A. Route 2, Box 54-A.

Q. What is your occupation, Mr. Barnes? A. I am a Civil Engineer.

(23) Q. From what school did you graduate? A. I am a graduate of Colorado A&M.

Q. What year? A. 1909.

Q. Have you ever been employed by the North Poudre Irrigation Company? A. Yes.

Q. During what years? A. 1919 to 1945, inclusive. 27 years.

Q. In what capacity? A. Engineer and Superintendent.

Q. You are familiar with the properties of North Poudre Irrigation Company? A. Yes.

Q. Where does the Water Supply Company ditch lie in relation to the North Poudre Ditch? A. Their system parallels the North Poudre Ditch and lies immediately below in the Poudre Valley.

Q. During the course of your employment did you have

occasion to become familiar with the physical structures and reservoirs of Water Supply and Storage Company? A. Yes. We were neighbors, cooperating, 25 years.

Q. Mr. Barnes, generally of what do the physical assets of these two companies consist? A. Storage reservoirs, diversion dams, ditches for carriage of water for irrigation, ditches for carrying water for storage reservoirs, distribution laterals and equipment and other things necessary for operation and maintenance.

124) Q. Were most of these structures constructed prior to March 1, 1913? A. Yes. Prior to that time or in the first case most of the structures were built out of wood which were replaced very soon, relatively soon, by concrete.

Q. Mr. Barnes, is the useful life of reservoirs subject to physical deterioration?

Mr. Garver: I object to that, Your Honor, on the ground that it is irrelevant.

The Court: Well, that gets around to your theory of the case again, Mr. Garver. It seems to me that if the Government's theory is that they make a capital contribution here and that that contribution goes into physical assets of the company, that they have the right to show whether or not those assets are of such a character that they depreciate and some of the money that you charge as a capital contribution goes to take care of depreciation. It seems to me it depends on your theory of the case. If that is your theory of the case I think the evidence is admissible.

Mr. Garver: I don't believe our theory of the case would allow depreciation to be used by the individual farmers. Depreciation of the company's property, that is, Your Honor.

125) The Court: Your point, then, is that because of the peculiar status of these mutual companies, these stockholders and mutual ditch companies have one added disadvantage, that they cannot take advantage of depreciation, whereas, if it was a profit-making organization they in effect could. That is what it boils down to, isn't it?

Mr. Garver: Well, I think that is true, that if the company doesn't pay taxes on its income there is no reason why it

should get the benefit of deductions.

The Court: Well, that is the company.

Mr. Garver: That's true. That is why I feel it is irrelevant, Your Honor.

Mr. Drexler: Well, I might say on our theory, on the plaintiffs' theory of the case, the testimony is also irrelevant, but we believe that we are obliged, in order to meet what we understand to be your theory, to offer the evidence. It seems to me it has to be one thing or the other. I appreciate that you have said that you were not seeking to disregard the corporate entity, but it seems to me that that in effect is what you are asking the Court to do and at least we ought to be entitled to show what physical depreciation there is as bearing on the nature of the payment made by the stockholder as an assessment.

The Court: Mr. Garver, say we didn't have a mutual ditch company here but there are a half a dozen farmers who live near a stream and they build a diversion dam, then a ditch is taken off from the stream, and then each of them has a lateral from that ditch and they don't have any corporation or any partnership, just by mutual agreement they assess each of them so much a year, and part of that assessment goes for repair work and also part of it is set aside in a little fund to take care of the depreciation which everyone knows occurs in such structures.. Couldn't those individuals take that as a deductible business ex expense?

126) Mr. Garver: Yes, I believe they could, Your Honor.

The Court: All right. Why can't they in this case, then, where you have a mutual not-for-profit company?

Mr. Garver: Well, I think you have a different situation. First of all, there is the obvious distinction that there is a corporation here. But, more than that, this is a corporation which is exempted from taxation or always has been so considered, so that they pay no taxes on their income, and to allow any deductions which would offset what income they have to be carried back into the individual farmers when the income is not taxable to the individual farmers I think would not be equitable.

The Court: All right, grant that. You say that's right. Who owns these capital assets in the company? Say the company is liquidated. Who gets its capital assets?

Mr. Garver: Your Honor, I had hoped we would be able to have some expert testimony on that. I haven't been able to find any law. The water rights, I understand, go back to the stockholders or at least they stay there, perhaps would be a better way to express it.

127) The Court: In other words, to look at it one way, your theory amounts to the fact that these farmers are making a capital contribution for some asset which is not theirs and in which they have no ownership. Is that a fair application of the tax law?

Mr. Garver: No, Your Honor, I don't think that is exactly what our theory is. The theory is that the contribution is to the capital of the corporation and that this contribution to the capital enhances the value of the stock. We are not trying to say that the farmers are purchasing these additional assets, whatever they may be.

The Court: Well, I see your point, Mr. Garver, and I am going to let the evidence in. You may have a continuing objection to all this line of evidence.

Mr. Garver: Thank you, Your Honor.

Q. (By Mr. Drexler): Mr. Barnes, I believe the gist of the question I asked you was, does anything happen which ultimately terminates the useful life of a reservoir? A. Yes.

Q. What is that? A. It is subject to depreciation from various causes.

128) Q. What happens physically to a reservoir? A. They will lose capacity by silting. The structure itself deteriorates with age, action by alkali and stream temperatures, so that the reservoir depreciates more or less at a rapid rate depending on its location.

Q. Did you make any or were there made under your direction any tests of the remaining capacity of the reservoirs in the

North Poudre System at any time? A. Yes, I made topographical surveys of nearly all their reservoirs at various times during the period when I was their engineer. These surveys were made to help in the administration of the water and also to determine what the loss by silting had been. Some reservoirs I surveyed I think as many as four times at various times, so that we are able to say quite definitely what the rate of depreciation is from silting.

Q. Can you state what the rate of siltation is in reservoirs of the North Poudre System? A. It varies with each individual reservoir depending on its location as far as flood water is concerned. We have found that the total life of two reservoirs has been about somewhere around 38 years. They were extreme instances of siltation. I found that the average anticipated life of reservoirs is about 140 years.

Q. Are you familiar with the rate of siltation as to reservoir No. 1 of the North Poudre Irrigation Company? A. Yes, I have made surveys of it.

129) Q. Do you know when that reservoir was built, Mr. Barnes?
A. From my memory, about 1881.

Q. Do you know when that was resurveyed? A. About 1920, around there.

Q. Can you tell me how much capacity had been lost between or up to the date of that resurvey? A. On this particular reservoir?

Q. Yes. A. I think I would have to refer to my notes.

Mr. Swanson: Your Honor please, it just occurs to me that the witness has given the estimated life of these reservoirs as averaging out at 140 years, as I understood it. I think the point that he had in mind or mentioned was the siltation. Now, it would seem to me that rather than go into each of these reservoirs, it would be sufficient to cover it as a whole, rather than going into each individual one. If there are different factors other than the siltation which they wish to go into I see no reason why that can't be done as a whole or on an average basis rather than as to each individual reservoir.

The Court: I agree with you. Your siltation rate is much

higher on your plains reservoirs than on the mountain reservoirs?

The Witness: That's right.

130) The Court: And in your plains reservoirs it depends for one thing on how much wash from heavy floods there might be?

The Witness: Right.

The Court: And the character of the soil that might wash?

The Witness: That's right.

The Court: If the plaintiffs' reservoirs silted up, it is common knowledge. Some of them are all silted up.

Q. (By Mr. Drexler): As a result of your resurveys and your studies, your familiarity with the reservoirs of the North Poudre Irrigation Company, can you state to me what, in your opinion, is the amount allocable to depreciation due to the silta tion for the years 1949 and 1950?

Mr. Swanson: Your Honor, please, that is a question of law. You determine the life of your reservoir in the beginning and how many years it will last and you charge off so much a year. It seems to me unless in the particular years, 1949 and 1950, they became obsolete or there was some basis to change the rate of de preciation, there is no sense in going into it with this witness.

Mr. Drexler: If the Court please, it seems to the plain tiffs that about all we could do would be to set up, through a properly qualified witness, the kind of engineering study and analysis on which we would be making a claim for depreciation if the corporation were filing a tax return. That we are prepared to do. This witness is probably better qualified than anybody else to give an engineering opinion on the rate of depreciation of reservoirs and other physical structures and I am just trying to get in the record what his opinion is.

131) The Court: Well, another thing that bothers me on that Isn't fundamentally, at least, the matter of depreciation, the allowance for depreciation and all that, an administrative

matter that ought to be handled administratively in the first instance, or is it? I don't know. I don't see how we can determine in this trial the depreciation rates on all the various items of property of these two companies. As a matter of fact, I would hesitate to go into it on your reservoirs because I think it is clear, take the Water Supply and Storage Company, the danger of siltation on Chambers Lake is a lot less than it is on Black Hollow Reservoir. You will agree with that, won't you?

The Witness: Yes.

The Court: You have so many factors going into it. I don't think it would be feasible in this trial to try and set up depreciation percentages on these various items of property. I think the most you can do, Mr. Drexler, is to show that you have a depreciation problem. Fairness and equity possibly require some treatment. In other words, the physical assets of the company, are they of a type that fairness and equity requires allowance of depreciation? You have shown it on reservoirs. Why not go at it generally that way rather than set up a specific item?

132) Mr. Drexler: Very good, Your Honor. As I say, we have no particular desire to go through this in detail, although I think in the first instance the claiming of depreciation is the taxpayers' problem. I think he has got to establish just how much it is and what his cost and what the 1913 value is. However, I will for the purpose of this trial follow the Court's suggestion.

Q. (By Mr. Drexler): Mr. Barnes, referring to the North Poudre Irrigation Company, I believe you testified that in addition to reservoirs North Poudre had concrete and steel structures? A. Yes, the North Poudre has some 2000 structures of concrete and steel.

Q. Some 2000. Can you make any general statement as to the dates which those were acquired or constructed? A. It was a continuing process. As wooden structures failed or had to be replaced they were replaced with concrete and steel, and that was an annual program which continued for over a considerable period of years, perhaps 20 years.

Q. What do you estimate to be the average useful life of the concrete and steel structures of the North Poudre Irrigation

Company? A. The big majority of them I think will have a life of about 50 years.

133) Q. Do you know how old the oldest structure still in use of North Poudre is? A. Well, I wouldn't know the age of the oldest structure, but I know of one or two structures which are around 50 years.

Q. How many structures been added in the last few years? A. By the last few years, what would you mean?

Q. Let's say the last ten years. A. Well, I am not competent to testify to that because I haven't been connected with the company since 1945. I think---well, I just can't say.

Q. What has happened to prices, to replacement costs of concrete and steel structures over the last 30 or 40 years, are they greatly up? A. Lots of them have tripled. I think the labor costs have tripled. Steel has quadrupled Cement has doubled in cost the last ten years.

Q. What do you do to a reservoir when it silts up? A. As far as I know, there is no practicable method of recovering the basin. It is possible in some cases to raise the dam and develop a larger basin. Usually that is too expensive. In the North Poudre case the reservoir has simply been abandoned. It is of no further use when the basis is gone.

Q. Mr. Barnes, passing from North Poudre to Water Supply and Storage Company, I believe you indicated that there is a slower siltation rate, as far as the reservoirs of water supply is concerned than the North Poudre? A. I haven't said that, I don't believe.

134) Q. Do you have any opinion as to whether siltation goes on at a faster or slower rate as between North Poudre and Water Storage? A. That would depend--

The Court: Mr. Drexler, you can't make a comparison on that. Water Supply and Storage has Chambers Lake up at the top of the mountains. It has reservoirs down in the plains. Anybody who knows anything about irrigation knows your mountain reservoirs don't silt up the way your plains reservoirs do. I think you better ask about specific reservoirs.

Q. (By Mr. Drexler): All right. Mr. Barnes, approximately how many reservoirs does Water Supply and Storage Company have? A. About 10, I think.

Q. Do any large number of those, in your opinion, have the same useful life? A. You mean a large number?

The Court: I don't understand that.

Q. (By Mr. Drexler). What is the typical useful life, what is the range of the useful lives of those reservoirs, from how many years to how many years? A. I don't think they have any reservoirs that are located on bad streams. I mean by that, streams that have violent flood loads in the summer and carry a lot of silt, which is true of some of the North Poudre reservoirs. They have a number of reservoirs which lie in chains, that is, one above the other, where the lower ones would get very little silt.

135) Q. Do those silt up in time, too? A. Oh, they would undoubtedly have a longer life, a much longer life where they lie below another reservoir because the upper one throughout its life would catch all the silt, or mostly all of it.

Q. Does Water Supply and Storage Company have cement and steel structures? A. Yes.

Q. Do you know about how many? A. No, I can't say of my own knowledge. I have a general idea that they have around five or six hundred, perhaps. They don't have near as many as the North Poudre Irrigation Company because they operate in a little different way. The North Poudre Irrigation Company operates a lateral distribution system and carries the water to practically all of the farms and they have to have a large number of small structures in those laterals. That the Water Supply and Storage does not have. The farmers there operate their own distribution system and of course that relieves their company of a big load there. The Water Supply and Storage System covers more land with less structures.

Q. Would there be any significant difference between the depreciation rate which I believe you estimated at 2 percent as between North Poudre and the Water Supply as to cement and steel structures? A. No, I think they would be comparable.

They were built--I think they would compare in age. In location, they are located in about the same kind of territory and I should think that the rate of depreciation would be comparable.

136) Q. Mr. Barnes, referring to the reservoirs of Water Supply and Storage Company, are there any reservoirs which have a useful life of less than 200 years, in your opinion? A. Yes, I think all their plains reservoirs are very apt to have a useful life less than 200 years.

Q. How many plains reservoirs do they have? A. Eight, I believe. They have Chambers Lake and Long Draw in their mountain system. I think the rest of them are all, could be called plains reservoirs.

Q. Would you be able to express an opinion as to the average useful life of the plains reservoirs of the Water Supply and Storage Company? A. I think it would be about the same as the North Poudre Irrigation Company. I think 100 years would perhaps be a good estimate of the life of the plains reservoirs.

Q. How about the life of the mountain reservoirs? A. Most of them have shown very much less silting, especially where they are built on a channel where the main stream runs right through the reservoir. We have set up for North Poudre Irrigation Company Mountain Reservoirs a life of about 200 years and it is indicated by a resurvey of the reservoirs that that is about right.

137) Mr. Drexler: I believe that's all. You may examine.

Cross-Examination By Mr. Swanson.

Q. Mr. Barnes, is either the North Poudre or the Water Supply connected to any other ditches farther down so that water could be carried through and conveyed to other areas? A. Yes. Each one of them, I think, has some extensions operated by other companies, mutual companies.

Q. If the stockholders, for example, in North Poudre Irrigation Company had no further use for the water, by some stretch of the imagination, then that water could be used on farther down the ditch by other people who were not stockholders who might purchase it from the company or from the stockholders,

is that right? I am talking now without great outlays of money being spent.

The Court: Mr. Swanson, I think that is a legal question.

Mr. Swanson: Probably is, Your Honor.

The Court: Let the witness answer if he can.

Mr. Swanson: I am trying to get at the physical fact of whether it could be used without great expenditures of money by other companies.

A. Oh, physically it would be possible to take the water into other states even, but probably not practical.

138) Q. Probably not economically feasible? A. It would require new construction. It would be about the same as developing new lands.

Q. This water, in the event it weren't being used for irrigation, could be used for domestic use, isn't that right?

Mr. Drexler: If the Court please--

Q. That, I know, goes back to questions of priority and that sort of thing, but I mean, it is so situated that it could be used by the towns in that area, isn't that right?

The Court: Well, Mr. Swanson, you are getting into a very interesting legal problem.

Mr. Swanson: Yes, I understand.

The Court: There have been some recent cases of the Supreme Court on that and I think there are some still pending. I don't believe the law is very well settled on that.

Mr. Swanson: I will withdraw the question. That's all I have.

The Court: Any further questions of Mr. Barnes?

Mr. Drexler: No further questions.

The Court: That's all, Mr. Barnes, thank you.

* * * * *

139) Mr. Drexler: If the Court please, subject to our right to submit by deposition the testimony of Mr. Glenn Saunders, the plaintiffs rest.

The Court: All right. What are the wishes of the Government? As I understood it from Counsel this morning, since Mr. Saunders is ill and can't appear in Court you have given consideration to taking his deposition?

Mr. Garver: Yes, Your Honor. We have agreed to take his deposition this afternoon.

The Court: All right. Shall we set the matter over, then--as I told you, it would be sometime in May--and then give consideration to his deposition and whatever defense the Government wishes to offer? Is that agreeable?

Mr. Garver: Yes, Your Honor.

The Court: How about Tuesday, May 8, at 9:30?

Mr. Swanson: Sounds satisfactory to the Government, Your Honor.

Mr. Drexler: Satisfactory to the plaintiffs, Your Honor.

The Court: All right. This matter will just stand in recess, then, and you will take your deposition and we will resume at 9:30 on Tuesday, May 8. At that time the Government will have the right to present whatever evidence it wishes in defense and we will wind the case up at that time.

* * * * *

141) The Court: We have set for this time Civil Action No. 4710, Victor H. Akin and others against the United States, continuation of trial to the Court. Are the parties ready?

Mr. Drexler: If the Court please, on behalf of the plaintiffs I would like to offer in evidence the deposition of Glenn Saunders, a witness on behalf of the plaintiffs, which was taken on March 20 at Mr. Saunders' home pursuant to stipulation of the parties. I believe that the original of the stipulation is in the file and both parties have copies. We reserved objections as to competency, materiality or relevancy to be made at the time the deposition was offered.

The Court: Mr. Drexler, suppose you have this marked for identification and offer it as an exhibit.

(Plaintiffs' Exhibit No. 4 marked for identification.)

Mr. Drexler: I offer Plaintiffs' Exhibit 4 in evidence

Mr. Swanson: Your Honor, please, I have no specific objections to the questions which have been offered. The testimony is the deposition of Glenn G. Saunders, who is an attorney admitted to practice before the Bar of the Supreme Court of Colorado and before this Court and who is a rather well-known authority on questions of water law. I think there isn't any doubt but what a good deal of the questions that were asked of Mr. Saunders were questions calling for his opinion in effect on matters of law, and the answers so indicate, even though some of the questions asked do not expressly call for opinions. But since the Court is well familiar with that situation I am not going to take the time to object to specific questions and answers.

142) The Court: Very well. Plaintiffs' Exhibit 4 will be received in evidence.

(Plaintiffs' Exhibit No. 4, for identification, was received in evidence.)

Mr. Swanson: Your Honor please, if I may interrupt a moment I would like to ask that Mr. Arthur Biggins, who is here with me, attorney from the Tax Division of the Department of Justice, be authorized to participate in these proceedings this morning with us.

The Court: Mr. Biggins, you are admitted to the bar of this Court for the purposes of this case.

Mr. Biggins: Thank you, Your Honor.

The Court: Well, now, I am bothered about the record in this case. For one thing, I have here a document headed "Offer to Stipulate Facts" filed January 7, 1955. That is signed by Stanley L. Drexler as Attorney for the Plaintiffs but it isn't signed by anybody for the Defendant.

Mr. Swanson: Your Honor, I don't believe that stipulation has been formally entered into. It was a mere offer to stipulate the facts.

143) Mr. Drexler: That was superseded, Your Honor, by a formal stipulation which was entered into.

The Court: All right. Here is one dated August 31, 1955.

Mr. Drexler: I believe that is the formal stipulation which was signed by the parties and offered and admitted in evidence.

The Court: Well, now, I think somebody had better look at this file and be sure. I went through the file this morning and we have a bunch of exhibits with strange numbers on them. The one on top here is Exhibit W-8.

Mr. Drexler: If the Court please, perhaps we didn't do it in the best possible way, but what Mr. Garver and Mr. Swanson and Mr. Sobol and I felt would make the clearest record, the stipulation accompanies a large number of exhibits which are joint exhibits and those exhibits have been lettered and numbered beginning with A-1 and running through something like AA-12 or something of the sort. That is, all of the exhibits which are referred to in the stipulation are joint exhibits, then the plaintiffs' exhibits have numbers and the defendant's exhibits have letters.

Mr. Swanson: That is right, as I understand it.

The Court: Well, now, that may be right, but at the moment the matter is extremely confusing to me. I can't figure out what's what.

144) Mr. Swanson: Your Honor, may I suggest that at a recess

we iron those matters out for Your Honor and either re-mark or have some statement jointly prepared showing what has been received and what has not?

The Court: I think you better because it certainly isn't clear now. There are a number of exhibits here, and then there is an envelope here which says "Exhibits A through O, inclusive."

Mr. Swanson: Those are documents which were originally attached to your Complaint, isn't that right?

Mr. Drexler: Yes, I believe that is correct.

The Court: Then when you get into the stipulation the first one referred to is P-1, then Q-2.

Mr. Drexler: Yes, I was mistaken. Instead of starting with A-1 we started with P-1 because they were attached to the complaint as exhibits and lettered, Exhibits A through O or N.

The Court: Is there any further evidence to be received in the case?

Mr. Swanson: Your Honor, I have just this further evidence. I would like to have marked here as Government's Exhibits two Audit Reports, one of the North Poudre Irrigation Company and the other the Water Supply and Storage Company which I intend to offer in evidence.

145) The Court: I wonder, Mr. Swanson, if before those are marked in evidence we hadn't better get this file straightened out and have the exhibits so we are clear. It may be that in identifying these we will get into some more complications. I would like to suggest that we take a ten minute recess and Counsel try and figure out what the status of the exhibits is.

(Recess taken.)

Mr. Swanson. Your Honor, I think those matters have now been straightened out. The exhbits A through O, which are in the yellow folder, were attached to the complaint and have been admitted in the defendant's answer as constituting true and

correct copies of the allegations made by the plaintiffs. So there is no question about those. Then the following exhibits which are there have been received in evidence and they run from P-1 through EE-16, and those are covered in the stipulation which has been signed by both parties. So those documents are already in evidence.

The plaintiff has offered the deposition of Mr. Saunders, to which the Government has no objection, and the plaintiffs, as I understand it, wish to offer plaintiffs' Exhibit 5, which is simply a certificate by the Secretary of State of the State of Colorado, which shows the Water Supply and Storage Company as still in existence August 29, 1955, and we have no objection to that exhibit.

The Court: All right. How about yours?

146) Mr. Swanson: Now the Government wishes to offer at this time Government's Exhibits 1 and 2. Government's Exhibit 1 is the Annual Audit Report of the Water Supply and Storage Company for the fiscal year ended November 30, 1955, which has been certified to by Mr. Rogers, H. W. Rogers, a Certified Public Accountant who has already testified in this case, and Government's Exhibit 2, which is a similar Annual Audit Report for the North Poudre Irrigation Company for the fiscal year ended December 31, 1955, again certified to by the same Mr. Rogers. I believe that the authenticity of these documents has been agreed upon, is that correct, Mr. Drexler?

Mr. Drexler: Yes. If the Court please, we furnished these documents at the Government's request but I do wish to object to their admission in evidence on the ground of relevancy. They covered the year ended December 31, 1955. The years before the Court are the years 1949 and 1950, and the plaintiffs believe that the audit report for a year some six years later is not relevant in this proceeding.

The Court: Well, they might have some significance as to the methods of operation of the two companies. Government's Exhibits 1 and 2 will be received.

(Government's Exhibits 1 and 2, for identification, were received in evidence.)

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Mr. Swanson: That is all the evidence the Government has to offer, Your Honor.

147) The Court: All right. Has the plaintiff now offered all its evidence?

Mr. Drexler: Yes, Your Honor.

The Court: So we have all the evidence in the case. Now, I assume Counsel wart to argue the case?

Mr. Drexler: That is corect as far as the plaintiff is concerned.

Mr. Swanson: We do, too, sir.

The Court: All right, go ahead, Mr. Drexler.

(Closing Argument on behalf of the Plaintiffs and the Government.)

The Court: Well, I think I might as well decide this at this time. You are going to have to bear with me a little because I haven't had too much of an opportunity to consolidate my thoughts the last few weeks.

In this case the plaintiffs are suing for a refund of income tax paid to the United States. The situation arises from the fact that the plaintiffs are farmers who received their water from certain mutual ditch companies. The two companies involved are the Water Supply and Storage Company and the North Poudre Irrigation Company. These are corporations not for profit, organized under Colorado law. They distribute water to the farmers who use the water for the growing of agricultural crops. In the years in question the annual assessments made by each company included items which the Government contends amount to contributions to capital assets and are in excess of the amount reasonably and properly required for repairs and maintenance and operation, and as to such portions of the assessments that are in excess of the requirements for maintenance and operation the Government contends that the farmer is not entitled to deduct such amounts as ordinary and necessary expenses paid or incurred during the taxable years

in question.

148) This is a case which possibly can have very extensive effects in the 17 Western States that are dependent upon the use of water for the irrigation of crops in order for there to be a productive agriculture. It is impossible for me to see the case in any other light. At the same time I can understand how a lawyer, gazing at the asphalt on Pennsylvania Avenue in Washington, D. C. and concerned only with the printed word of the Federal Tax Laws and the decisions based thereon, in forming the policies of the Internal Revenue Bureau might possibly have a different concept of the situation.

The use of these mutual ditch companies is not confined to the State of Colorado. It is common in the Western States. The Supreme Court of Colorado in the case of Coffin v. The Left Hand Ditch Company, 6 Colorado, page 443, had some discussion of the situation which confronted the Colorado settlers. It said this:

"The climate is dry, and the soil, when moistened only by the usual rainfall, is arid and unproductive; except in a few favored sections, artificial irrigation for agriculture is an absolute necessity. Water in the various streams thus acquires a value unknown in moister climates. Instead of being a mere incident to the soil, it rises, when appropriated, to the dignity of a distinct usufructuary estate, or right of property. It has always been the policy of the national, as well as the territorial and state governments, to encourage the diversion and use of water in this country for agriculture; and vast expenditures of time and money have been made in reclaiming and fertilizing by irrigation portions of our unproductive territory. Houses have been built, and permanent improvements made; the soil has been cultivated, and thousands of acres have been rendered immensely valuable, with the understanding th__ appropriations of water would be protected. Deny the doctrine of priority or superiority of right by priority of appropriation, and a great part of the value of all this property is at once destroyed."

149) The Court goes on to say, on the same page:

"* * * we think it is, and has always been, the duty of the national and state governments to protect (this right). The right itself, and the obligation to protect it, existed prior

to legislation on the subject of irrigation."

And I might add parenthetically it existed prior to legislation on the subject of income tax liability.

150) The Supreme Court of the United States has recognized the same thing. Among other cases wherein it has been recognized is the decision in Clark v. Nash, 198 U.S. 361. There in talking about the difference between the East and the West the Court says, on page 370:

"The rights of a riparian owner in and to the use of the water flowing by his land are not the same in the arid and mountainous States of the West that they are in the States of the East. These rights have been altered by many of the Western States, by their constitutions and laws, because of the totally different circumstances in which their inhabitants are placed, from those that exist in the States of the East, and such alterations have been made for the very purpose of thereby contributing to the growth and prosperity of those States arising from mining and the cultivation of an otherwise valueless soil, by means of irrigation. This court must recognize the difference of climate and soil, which render necessary these different laws in the States so situated."

Now, I recognize those are general statements. To me they have some pertinence here.

The first Colorado Supreme Court case that discusses the status of these companies seems to be Kendrick v. Twin Lakes Reservoir Company, 58 Colorado 281. Prior to that case there were innumerable decisions that need not be mentioned, which pointed out consistently, time after time, that in a ditch company or a reservoir company the water rights are not owned by the company but are owned by those who put the water to beneficial use. That is elementary Hornbook law in Colorado. In the Kendrick case, which involved a mutual reservoir Company, the Court on page 282 says:

151) "The corporation is purely a mutual reservoir company, in which the capital stock stands for and represents the consumer's interest in the reservoir, canal and water rights. The benefit derived from owning the stock, is the exclusive use of the water it represents. It is not a dividend corporation, a

dividend has never been declared, and under its charter, never can be declared on its capital stock."

That decision was in 1914. As I recall, that is the year after the income tax amendment to the Federal Constitution was adopted. The Court said then that one of these companies was not a dividend corporation.

There are a number of other cases. One which is of some interest because it was decided by my colleague, Judge William Lee Knous, when he was on the Supreme Court of Colorado, is Beaty v. Commissioners, 101 Colorado 346. Reading from page 351, this is the same quotation Mr. Swanson read this morning, Judge Knous said this:

"It definitely appears that this mutual canal company was organized for the convenience of its members in the distribution to them of their water for use upon their lands in proportion to their respective interests. Under these circumstances the stock certificates of the canal company, in the form in which they were issued and held by the plaintiff, were merely the muniments of title to her water right, which water right, the thing of value owned by her, unquestionably was real estate and not corporate stock."

152) Judge Knous refers to some other decisions where the same holding is made.

The last case that I know of is also one which Mr. Swanson mentioned this morning, Billings v. Industrial Commission, which involved a question of whether or not an injury received by an employee of a mutual ditch company was compensable. The Court in discussing the character of these companies says this:

"Under the undisputed facts of this case the conclusion is inescapable that the Billings Ditch is a mutual irrigation ditch, and that the corporation is merely the vehicle by which its owners operate and manage its affairs. It was neither organized, nor is it operated, for profit, but solely for the convenience of its members in the management of their irrigation system and the distribution of the proper apportionment of water to the owners as their respective interests may appear; the shares of stock being merely incidental to the ownership of the water rights." Then it cites a number of cases.

"The shares of stock," says the Court "in the Billings Ditch Company are not personal property, but represent varying interests in separate parcels of real estate. The opinion cites some more cases and goes on:

153) "What it does, and the practice and policy adopted by a corporation in its operation, rather than the language contained in its articles of incorporation, are determinative of its character."

So we have here a couple of mutual ditch companies, corporations not for profit, that serve as the facilities through which the farmers get the water which they have to have to irrigate their lands to raise crops. Now, it is true that these companies have constructed works, reservoirs, canal systems, diversion works and things like that. But as said in the 58 Colorado case, those are of value only as they permit the diversion and use of water through them, and separate and apart from that they have no value. It is a matter of common knowledge that here on the Eastern Slope of Colorado the streams have been over-appropriated for many, many years. In fact, in recent years 1870 rights on the South Platte yielded very little water. That being true, it seems to me that it is apparent, I think the evidence in this case justifies the conclusion, that these expenditures which are made by these companies are merely to continue the assured availability and continued availability of the water divertible under the rights which are owned and used by the shareholders in the company. They do not create capital in the true sense of the word. The value is in the water rights and the rights to divert the water are old, old rights. The expenditure of this new money does not add one iota to the yield of any of those water rights, doesn't get any more water from them. All it does is to facilitate, expedite or assist, whatever you want to call it, in the diversion and distribution of the water which is covered by these old rights.

154) So you have a situation where the Government, in effect, claims that part of the charge which the farmer pays is not a proper business expense because it goes to a capital item, the retirement of bonded debt, the purchase of a dragline, the purchase of a truck, the building of a new diversion structure, or the purchase of a right of way that may be necessary in order to add to the usefulness of a ditch. None of those things have any real value separate and apart from the water because if it wasn't for the water they would not be needed. They only assist

in getting the water from the streams, the lakes, to the soil where it grows crops.

The testimony is clear that the assessments made against these farmers by the two companies had to be paid or the farmers wouldn't get any water. They couldn't pay part of the assessment and demand the right to water. They had to pay the whole assessment in order to get their water. If they didn't pay it the water was shut off and their stock would be sold to somebody who was willing to pay for it. We are not concerned here with a case of the taxability of a capital gain on the sale of a farm. We are not concerned with the taxability of income to one of these companies. We are not concerned with a possible tax on the proceeds from a liquidation of a company and distribution of its assets among those entitled thereto. We are just concerned with the question of whether or not a farmer is entitled to deduct as an ordinary and necessary business expense the sum of money he had to pay in order to get water for the ensuing year.

155) The Supreme Court of the United States and the Supreme Court of Colorado has recognized the absolute necessity of the use of water in semi-arid regions, such as we have here, for irrigation. The Supreme Court of Colorado has recognized the status of these companies as being that of facilities which are organized to get the water to the farmers. The Supreme Court of Colorado has said that the stock certificates represent only the right of the farmer to receive water, that they are not personal property but real property.

Under all the circumstances, it seems to me that these assessments which have to be paid in order for the farmer to receive the water to grow his crops are ordinary and necessary expenses paid or incurred during the taxable year in carrying out the trade or business of farming. That being so, under the applicable section of the income tax laws they are deductible. Accordingly, judgment will be entered in favor of the taxpayers and against the Government.

156) Mr. Drexler, you may prepare findings of fact, conclusions of law and judgment to carry the views expressed by me into effect.

Mr. Swanson, are we going to get the situation where we will have to wait for computations from Washington?

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Mr. Swanson: I suppose we will, but I think we can expedite that in some way or other, and if Your Honor would direct the findings of fact and conclusions of law be submitted within, say, 30 days, and a judgment be tendered setting forth the interest due up until that point, I think we can have such a computation made so it can be inserted in the final judgment by that time.

The Court: All right. The order will be that the plaintiff will submit findings of fact, conclusions of law and judgment on June 8, 1956, and if you figure the interest to June 8 and have the judgment all prepared, do not leave any blanks for the insertion of any interest. I think if the two of you can work together you can work that out. But, Mr. Drexler, if you can't get together on the interest I want you to prepare a form which has the interest in and if you can't iron it out without a hearing I will sign the judgment as you have it, and under the rules the Government will then have ten days to object. Is that satisfactory, Mr. Swanson?

157) Mr. Swanson: Yes, that is satisfactory.

The Court: All right. I have enjoyed this case. Mr. Swanson, I think if the Bureau of Internal Revenue is going to give consideration to matters like this in connection with irrigating in the West, they should rely a little more on local and less on Washington advice.

Plaintiffs' Exhibit 4.

160) Pursuant to oral stipulation, the deposition of Glenn C. Saunders, called as a witness by the plaintiffs, was taken at 240 South Clermont Street, in the City and County of Denver, State of Colorado, beginning at the hour of two-thirty o'clock in the afternoon of the 20th day of March, 1956, before Bertram Naster, a Notary Public in and for the City and County of Denver and State of Colorado;

The plaintiffs appearing by their attorneys, Mr. Stanley L. Drexler and Mr. Ellis Sobol;

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And the defendant appearing by its attorney, Mr. Theodore M. Garver, Attorney, Tax Division, Department of Justice, Washington, D. C.

It being agreed by the respective parties that all objections as to competency, materiality or relevancy may be reserved to be made and ruled upon at such time as said deposition or any part thereof is sought to be introduced in evidence.

161) Whereupon, the following proceedings were had

Mr. Drexler: The parties waive notice of the time and place of the taking of the deposition, and waive signature of the deposition. They stipulate that all objections to the relevancy, competency or materiality of any question and answer may be raised at the time that the deposition is offered in evidence.

Glenn G. Saunders, called as a witness by the plaintiffs, being first duly sworn, testified as follows:

Direct Examination By Mr. Drexler.

Q. You are Glenn Saunders? A. My name is Glenn G. Saunders. I am an attorney at law resident at Denver, Colorado; have been practicing since 1929, actively engaged, principally, in water and closely related fields.

Mr. Garver: The defendant will stipulate Mr. Saunders' qualifications as an expert on water rights.

Mr. Drexler: All right. If you don't mind, I'd like to get just a little background into the record in addition to that.

162) Q. (By Mr. Drexler): Mr. Saunders, among your present duties is that you are the attorney for the Denver Water Board, is that correct? A. Yes, have been the chief counsel for the Denver Water Board since 1935.

Q. In the course of your practice, Mr. Saunders, have you had occasion to be concerned with the workings of mutual irrigation companies, corporations? A. Yes, a good many of them over the State of Colorado as a whole, and in its various water sheds. Some of these mutual irrigation companies are connected with ditches

owned by the Denver Water Department, but most of those that I have had anything to do with have been related to the affairs of other clients than the Denver Water Department.

Q. Can you state generally the circumstances under which mutual irrigation corporations have been formed? A. Historically, the first mutual irrigation companies were formed to take over existing structures built on a partnership basis, and in which the owners found it inconvenient to operate the ditches as tenants in common, and seeking a ready means of arranging for the selection of a ditch rider and for the collection of the money necessary to maintain and operate such ditches, they turned to the mutual irrigation ditch, which is a corporation under the laws of Colorado not for profit, but a device in practice used to share a common obligation to keep the means of carrying water from the natural water course to its place of use, in proper condition for that purpose. Also, for relatively small enterprises, mutual irrigation ditch companies were formed to construct ditches designed to carry water from the natural water course to the place of use, and as a device for sharing among the various prospective users the burden of creating, and later maintaining, such devices. The mutual ditch company is to be distinguished from your public irrigation district, which is also mutual in a sense, in that the public mutual irrigation district is one in which everyone in a given area must participate, and the costs of its operation are borne as a tax upon all in the area; while a private mutual irrigation district, or company, rather, is voluntary, and applies only to those who choose to enter into it.

163) Further to define the kind of an entity it is, in the case of your public irrigation district, which is the kind that we deal with when we have a Bureau of Reclamation enterprise and which makes contracts with the Department of Interior, once in the district, the land owner must stay in the district. His land is burdened with the obligations of the district. His water rights are burdened with those obligations, while in the case of the mutual irrigation district, in the absence of some very special provision, the member is free to come and go if he so chooses. And we have had a number of cases in Colorado where one or more members of a mutual irrigation district, for some reason, have withdrawn and carried on the functions of getting the water from the stream to their lands independently of the mutual irrigation district--or mutual irrigation company.

164) Q. Can you also distinguish, Mr. Saunders, between a

mutual irrigation company and a so-called carrier ditch company? A. Yes. At the opening of civilization in this state, there was no capital or wealth which had been created here, and outside capital from the Eastern United States, much of it from England, was brought here for the development of irrigation projection. The usual pattern of such profit making development was for the entrepreneur to acquire an area of land thought to be susceptible of irrigation, and then separately and apart from the ownership of that land, to create what we know as a carrier ditch corporation, which is a public utility in all its aspects. This public utility, peculiarly enough, is subject to regulation by the Boards of County Commissioners where the ditch is located. The carrier makes the appropriation of water, constructs the ditch, and sells the water from the ditch to the land owners under the ditch by virtue of contracts, which provide that upon non-payment of assessments, and because these contracts were bought on time mostly, upon non-payment of the purchase price for the water, they might become forfeit and go back to the company from which they originated. Now our law at this point is a bit peculiar. While the cases show that the creation of the water right is so closely akin to its being applied to beneficial use, that the water user gets more than a mere lease or contract right from the carrier ditch, nevertheless upon the failure of payment of some obligation due the carrier, then that water right reverts entirely to the carrier, is subject to re-sale by the carrier. That principle was carried out by our Supreme Court within the last few months in the Wanamaker ditch case.

165) In other words, with respect to a mutual irrigation ditch company, while that company also holds a legal title to the water rights attached to the ditch, when a sale of a water right under the ditch is made for failure to meet some obligation due the ditch company, the overplus of that sale must be rendered to the water user, who, again, is the equitable owner of the water right, with the legal title vested in the ditch company. The purpose of the sale being to make good the cost of maintenance and operation, which other water users have had to pay because of the failure of the delinquent water user to pay his fair share of the cost of such maintenance and operation.

Now, another thing that distinguishes all water carriage charges in Colorado so far as ditches are concerned, is that the charges are based upon the cost of continuously maintaining the structures necessary to the delivery, and replacing their worn

out parts as they do wear out, and not upon the volume of water delivered. Whether the ditch carries any water this season or not, the charges go on, because under our law, prior in time is prior in right, and there are instances where we are in short supply of natural water when a ditch may run only a few days of the year or sometimes not at all, and yet it is necessary to maintain that ditch and have it ready to carry water in case nature through storms provides a supply. Well, maybe that's an answer to that question - kind of a long one. What you want, I guess, is the background of this thing.

166) Q. That is right. As I understand it, you have stated that the mutual irrigation company owns legal title to the water right, the individual land owners are the equitable owners of that title? A. Yes, sir.

Q. And how in the case of water rights, where delivery is made through the ditch of the mutual irrigation company, is title to the water rights usually transferred? A. Well, that varies from locale to locale. In water, the customs of our people have been the creators of the water law, and it isn't completely uniform. There are areas where it is considered that the transfer of the stock would transfer the water right. But, where the water right is attached to the land, as it always is, at the place of use, the real conveyance of that water is ordinarily done by the deed to the land itself. Generally speaking, water in Colorado is considered to be part and parcel of the land on which it is used, and the conveyance of the land by the customary deed, including the appurtenances, prima facie creates an inference of an intention to convey the water appurtenant to that land, even though there is no sale of the stock. The careful scrivener, of course, tries to cover a transfer by both stock transfer and instrument in the nature of a deed, because particularly the stock is evidence that the particular piece of land to which the water is attached clearly has a right to have that water carried in that particular mutual ditch. A man can sell his water separate and apart from the land in Colorado. He could sell them without the right of carriage to that land; and, therefore, the desirable thing is to make it clear, when mutual irrigation water is sold, that the water has been transferred by reference to it in the deed, and that the right of carriage has been transferred by a transfer of the stock itself. Actually, in practice, there are many mutual irrigation companies that are so loosely run that they haven't had stock transfers for years. You can't find the stock transfer book.

167) Q. Could you express an opinion, Mr. Saunders, from your general knowledge of mutual irrigation districts, whether-- A. Districts, or companies?

Q. I am sorry--corporations--whether upon the dissolution of such a corporation and the distribution of its assets, the stockholders would receive anything of value? A. It would simply be a new form of the same value they have already had. Stockholders in a mutual irrigation company hold a number of shares in proportion to the total amount of water they have in the ditch. For example, if a ditch has four second feet and John Doe owns six hundred acres and one second foot, he would own a fourth of the stock in the company. Upon dissolution he would simply get one second foot of water, together with an easement in the ditch to carry that one second foot. He would have exactly the same thing he had when there was a mutual ditch company owning the physical structures, except that now the structures would be owned in tenancy in common among him and the other users through the ditch.

168) Q. In the course of your experience with mutual irrigation corporations, have you ever run into any situation where there was speculation in the stock of such corporations? A. No. Water in ditches has not been a profitable venture in Colorado. The profit lies in the value of the land to which the water is attached, and the structure for carrying the water has always been more of a burden than an asset. It is a necessary part of the whole scheme, but it is the expensive and burdensome part. The money is made out of the product of the land and not out of the facility for carrying the water.

Q. With reference to the annual assessments levied by mutual irrigation corporation, do you know for what purposes the assessments may be levied? A. The assessments are invariably levied to defray the cost of maintenance and operation. Actually, they try to keep the assessments up to where the ditch is kept at par, but in practice this often fails to occur; but, we'll say there is a flume across a draw, pretty expensive. It maybe has to be replaced every twenty years. During the twenty years, very little work is done on it, a board or two nailed on, a strut replaced. These companies are so loosely run that they don't set up actual cash reserves against the day when that structure will go out--have to be replaced. And yet, all the time, there is an actual deferred maintenance going on on such a structure; so that,

when it has to be replaced, it may be that that year's assessment can't be high enough to replace it. The ditch company will then go to the bank, borrow enough to replace the structure, and pay it off in the years subsequent. Some of the ditches that are run with more foresight, actually do lay up cash reserves against these eventualities; but when they get all through, they are right back where they started. They have still got a ditch to carry their water, and they haven't added anything to it. They have just found a rather unbusinesslike way of meeting deferred maintenance. Now, in a bigger ditch that has a good many structures, the directors will look ahead and have a plan of replacing the various structures from time to time, so that the various expensive units will be replaced in succession, so as to keep the whole structure at about par all the time. But, in so many of these little ditches that much foresight is not used, and the deferred maintenance is rather indifferently taken care of.

169) Q. Are mutual irrigation corporations regarded as separate corporate entities apart from their stockholders for most legal purposes, such as liability for tort, and so forth? A. For liability for tort, they are separate from their stockholders. The mutual company must respond to a suit for abandonment of a water right, and the stockholder will be bound by the rules of such a suit. He may step into court if his mutual company fails to properly defend, and yet in the attitude of the law, the mutual ditch company does stand in the place of the stockholders, and insulates him from tort liability, that is, personal tort liability. So that there is an advantage to the creation of the mutual corporation over the tenancy in common, and that is one of the reasons for forming such companies, particularly for reservoirs, where the liability is very high, being that of an insurer, except for the act of God and the public enemy.

170) Q. How is the amount of water which each stockholder in a mutual ditch company receives, determined each year? A. Basically, each receives an amount of water proportioned to the number of his shares, and in turn he owns a number of shares in proportion to his sharing in the total enterprise. There are mutual ditch companies with several classes of stock. Sometimes the original ditch company is enlarged, and the old company taken over by a new company under contracts, creating various shares with the rights to various portions of the total priority system awarded to that ditch. But, upon the whole, it is a proportional arrangement, representing by stock the proportion of the interest

of the individual stockholder in the whole enterprise.

171) Q. Could you express an opinion as to the factors which would influence the price at which shares of stock in a mutual irrigation district could be sold? A. Well, frankly, I don't know of any instance in which mutual irrigation company stock has been sold as stock. It just isn't traded in. Now that is all there is to it. It is transferred invariably in connection with the sales of the land to which the water is attached. To the usual business mind, used to trading in stocks, well, like Public Service Company, or Consolidated Edison, this concept doesn't apply at all. This stock in and of itself just doesn't have any value apart from the right to have the water carried to the land where the water is used. Now, of course, it may be that my experience is deficient at this point, but I have had quite a lot of experience with mutual ditch stock and companies, and I have never seen one yet where the stock had any value as stock, apart from the land on which the water was used. And that covers the Arkansas Valley and the Purgatoire and the Platte Valley and some in western Colorado.

Q. We have had some testimony in this case, Mr. Saunders to the effect that a number of stockholders in the North Poudre and the Water Supply Company, have acquired additional water, or rather additional stock, representing additional water, from other stockholders in order better to irrigate their land. Is that a situation which sometimes obtains? A. Yes, that is a common practice. It's become common around Denver particularly, because of the encroachment of the urban area into the irrigated areas, and where a man has a deficient amount of stock to irrigate the land he owns, then he can buy some stock from a man whose land has been covered by water from some other source. He will then in effect sell his water, adjudicated to his land to irrigation purposes. for use on another piece of land. But, again, the thing that he is selling is the water, the irrigation water off of his land, which has now perhaps been taken care of by the city of Denver or the city of Westminster or some other town, and transferred the water to a man who needs more water on his land. And again it is the value of the water that is transferred, rather than the stock. Always, the value is associated with the water, rather than with the stock. Now, I have just recently been through one of those transactions myself--well, I shouldn't say one--I have been through several, but, I have one in mind, in which in each case I was very careful on taking the stock of the mutual ditch company, to be

certain that the water supposedly represented by that stock had actually been used and not abandoned, because if it had been abandoned, the stock would be meaningless. If the water is gone, the stock might just as well not be transferred.

173) Q. Well, what influence, if any, would the amount of the bonded indebtedness of the mutual irrigation company have on the value of the stock, the market value of the stock? A. Well, your question--

Q. In your opinion. A. Your question, of course, is framed again in the language of the stock market. And we come back to the fact that the bonded indebtedness would have an effect, rather upon the value of the water, than on the stock as such. The bonded indebtedness, of course, creates a charge against the water represented by that stock. It diminishes its value to that extent. But, always, we associate the values to the water, rather than to the stock. In mutual companies, we think of the two as absolutely identical. Now, that wouldn't necessarily be true in a carrier ditch company. A carrier ditch's stock might be represented by how much unsold water was left in the company, and the chances for selling it on land under the ditch. In the mutual company, we wouldn't look at it that way.

Q. Well, then, what if anything does a stockholder in a mutual ditch company get when he pays an assessment? What does he get over and above the cost of maintenance for what he pays? A. That is all he gets--is the right to have his ditch maintained in readiness to carry water when available in the public stream, and the right to have the officers use that money to keep the ditch structure up to par so that as the years go on, there will always be a ditch there ready to carry his water. Assessment beyond that point would be invalid. You can't assess mutual ditch companies to go out and speculate in land, drill oil wells, or something of that kind. All they can do is--the officers maintain that ditch in perpetuity.

174) Q. What happens if the stockholder doesn't pay his assessment? A. Under our statute, this common contribution can be enforced as to ditches by the sale of the stock and the water it represents. In the case of reservoirs, the statute is deficient. I don't know how to do it. You just have to pressure him as neighbors--when you get a mutual reservoir and some fellow won't pay, about all you can do is refuse to deliver his water.

You can't make him pay.

Q. Would a mutual irrigation company be entitled to sell water, let's say, to an industrial concern? A. Yes. In Colorado, one of the incidents of a water right is the right to change the point of diversion and place and character of the use, provided such change does not injure other appropriators. But, the characteristic of the water right would still be limited by the same factors which attach to it in the hands of the grantor, the grantee could not rise to a higher type of a title than his grantor had, and his relation to the other users would still have to be the same, and he wouldn't get a right to an absolute quantity of water any more than anybody else.

175) Q. Are you referring to sale of stock or sale of water, and water as water right or water as a -- A. Again, the two go together. The owner of a water right can't have his cake and eat it too. He can't continue to use it on his farm and then sell it to some industrial user to use when he is not using it on his farm, thus, doubling up on the use of water, because other appropriators have a right to a continuance of the stream conditions as they were at the time they made their appropriations, and the law does not permit us to make double use of our water rights. You can change the use from one use to another, but you can't do it in such a way as to double the use--put it on a piece of land today and through a cooling tower the next. We have recent examples of that right here, where the Public Service Company is erecting great cooling towers, and they are having to acquire an independent water supply for that.

Mr. Drexler: You may examine.

Cross-Examination By Mr. Garver.

Q. Mr. Saunders, is a mutual ditch company subject to any sort of municipal control as to the amount its assessments must be? A. It is not subject to control of any agency of the State of Colorado or any of the arms of the state as is a carrier ditch. It is subject only to the general power of the courts of equity to see that justice is done as among common owners of property. An example of that is a case whose title I can't recall, but an opinion written by Justice Burke, in which he found an inequitable practice occurring among three classes of stock in a mutual ditch company, and he said the courts had power to correct the inequity,

but so far as the general rule is concerned, there is no governmental authority regulating mutual ditch companies in any particular. They are entirely self-contained and self-regulated.

176) Q. Is there any limitation, either by custom, or in the laws of Colorado, on the purpose for which assessments may be made? A. I think by law, but I--I haven't looked any law up to prepare for this testimony, so, you know how law can get away from you; but I can tell you what actually happens, and I think it's under the law too, that the only purpose for which you can make an assessment in a mutual ditch is to keep that ditch in condition to carry water to the land, and you just can't raise money for an extension of the ditch, the creation of new water rights, or anything of the kind. That is the reason that when some of the old ditches were obviously susceptible of enlargement, new corporations were formed to do the enlargement, and then took over the old ditch by contract. As an example, the Brantner, and the New Brantner Ditch Company.

Q. Would your comments as to the enlargement or extension of ditches also apply to the paying off of a bonded indebtedness which was originally used to, or incurred to, pay for the facilities of the ditch company? A. If, at the initiation of the ditch company, sufficient capital was not subscribed by the land owners to fully complete the ditch, and money is borrowed, and evidenced by a mortgage on the structures of the ditch company, then the land owners can be required to pay sufficient assessments to liquidate original cost; just the same as later on they can be required to liquidate borrowings to maintain; just as when as tenants in common, a number of farmers get together and build a ditch, and borrow money, they have to pay that money back, and it can be secured by whatever they have to make certain re-payment of the debt.

177) Q. Now, assuming that a mutual ditch company made an assessment to purchase a right of way, or extend a ditch, would you say that that assessment was not valid? A. I'd say that wasn't valid. The present owner of a mutual ditch can't be imposed upon to extend or add to its works. He can remain content with what he has and insist that the company limit itself to the operation it already has under way. He can't be forced to invest his money in an additional enterprise, I don't believe.

Q. Well, supposing that, nevertheless, such an assess-

ment was made and used to purchase a right of way. Could you tell me what effect that would be? Would the ownership of the right of way be in the ditch company, or, because of the invalidity of the assessment, would it be in the individual stockholders? A. No, I think that if that were done and the stockholder voluntarily paid his assessment, that the ditch company would hold the title, the legal title to the extension, and whether or not that was an asset to the original owner would depend upon the circumstances of the case.

178) I don't see how an original owner could be improved in his position by a later extension which would necessarily apply to a junior water right to the one he already had, because in this state the seniority of water rights is the thing that gives them their value. So, I'd say that the old owner wasn't getting any improvement to his situation. That's why they would buck and wouldn't go along with an assessment of that kind.

Q. Well, supposing that a right of way was purchased from a reservoir into the company's main ditch. Now, would it be possible for that to benefit the original owners? A. Yes, very definitely, and that's been done in some cases, because in the early days it was thought there was more water here, and that it would flow more steadily than it does, and water, direct water rights--those diverted for immediate use--were found to be inadequate in later seasons of the year when the streams diminish in their flow, and it's been necessary to supplement the original rights with storage rights in order to maintain the value that the owner originally thought he had in his water.

A good many of these people came out here and thought these streams would flow all the time like they do back East. A little later they found that they didn't have the value that they'd thought they bought, because when our streams diminish in quantity along in July and August, the senior rights take all the water, and the juniors are out, so that the juniors have been forced in many cases to, you might say, recoup their loss of water that they thought they had, by finding some way of either building reservoirs or buying storage water from somebody else in order to finish out their crops, which, in the early days they could do, but recently haven't been able to, because our weather has been changing and we have been drying up for the last fifty years; so that in order to get themselves back to as good a situation as they thought they were in water-wise, they've had to go

out and find some reservoir water somewhere, and a good many of them have done it.

179) Q. Mr. Saunders, I believe you testified on direct examination that you knew of several instances when members had withdrawn from mutual ditch companies and had found their own independent ways to get the water from the primary source to their land. I wonder if you could tell me in those instances what disposition was made of that portion of the assets of the mutual ditch company, that is, the assets for carrying water, to which the stockholders presumably would have been entitled? A. Well, to give you an example, a man by the name of Lammers, below Denver, on the Platte River--obviously that is an English-speaking name--in one year he went to the annual meeting, it was conducted entirely in Italian. When they got through they told him what his assessment was. He was so angry he pulled out, built his own diversion dam, at considerable cost, ran the water down to the same ditch he'd been using before, the old Heiler Ditch, ran the water through the same ditch, and then took it out his diversion box in the ditch, thus, using the ditch for his own uses and personally doing a share of the maintenance work on the ditch, carrying the water in exactly the same canal line, but from his own headgate so that he could divert from the river by himself, go out on the ditch and do what he thought was a fair amount of work, and then take the water out at his own behest. So, he simply changed his title, you might say, from that of being a share holder in the ditch, to a tenant in common of the same ditch, because he simply wasn't going to stand for having these foreigners run his water, as he considered it. That's been rectified now because the second generation of Italians all speak English and everybody's happy.

180) Q. Mr. Saunders, I also believe you testified on direct examination that charges for all water, and I believe that included assessments for mutual ditch companies, were based on the cost of maintaining the ditches and equipment, and so forth. On cross-examination you testified that assessments could also be made to pay off a bonded indebtedness? A. Uh huh.

181) Q. And now, in view of that, would it be correct to say that in speaking of maintenance costs and so forth, on direct examination, you were also speaking of any costs that might have been necessary to pay off a bonded indebtedness? A. You will remember that when I was asked about the formation of these

mutual companies, I said they were really two general classes of such companies, those that took over an existing structure, in which event I think it would be improper to pay off any bonded indebtedness for an extension; but, another class of mutual ditch are those which were formed to originally construct, and it's those that can properly levy assessments to pay off the original cost; just as the original farmer, if he'd built it in tenancy in common, could bond his land to see that the ditch was paid for. But, once the thing is paid for, then I don't think they can go on and extend it any further.

Q. On direct examination, I believe you testified, Mr. Saunders, that on the dissolution of a mutual ditch company, the share holders would have approximately the same rights they had when the company was in existence, except that they would hold them as tenants in common, and not as stockholders. Is that correct? A. Yes, that's the way it works out, and has a good many times.

Q. And further, that the stockholder would get an easement in the ditch which had been used to carry the water? A. That's right.

182) Q. Well, could you tell me what sort of an easement that would be? Would it be an easement which would be valid only as long as the ditch was used to carry water? A. Well, as among the users, it's the same sort of thing that they had before, but an easement for a ditch is like any other property right which is carved out of a basic fee. They can be abandoned by intention of the owner of the easement; and whether it's the mutual ditch company that intended to abaondon or the tenant in common, the result on the title would be the same.

The way the thing actually works is that after a time, with some of these mutual companies, they are so rather sloppily run that they don't even renew their corporate charter, or else they don't elect officers, don't have stockholders' meetings for years, and the people just pass the hat once in a while to get money to do something they have to do, and the rest of the time they just put their labors into maintaining the ditch; and the mutual ditch companies just sort of--just dissolve into thin air by non-use, and these people just continue to operate the ditch by hand.

It's a sort of--same comparison as you have between barter and the use of a common medium of exchange, money, they just cease to use the common medium of exchange, a mutual ditch company, and barter their own time.

183) Q. Mr. Saunders, I believe you also testified on direct examination that the stock in these mutual ditch companies has no value, apart from the right to the water it represents. A. Uh huh.

Q. And furthermore, that the sales of stock are actually and intended by the parties to be sales of water rights. Now, I wonder if these water rights would be more valuable if the mutual ditch company had a smaller indebtedness. Would that be one factor that might affect the price of the stock? A. Well, we have to go back just a little in your question. I don't separate a value for the stock--I don't separate tne value of the stock from the value of the land at all. The indebtedness against the mutual ditch company if it were considerable at all, would be reflected in the price of the sale of the land to which the water was attached, because it's something the land owner would have to pay in order to get his water down to the land.

So, since the stock itself doesn't carry value separate and apart from the land, the effect on value created by an indebtedness is reflected rather in the sale price of the land, and water, together, rather than being reflected as a value of the stock. The thing is, we are so accustomed to think of stock as having some intrinsic value within itself, as representing an ongoing corporation that is in business generally, while in the case of a mutual irrigation company, we don't have a company which is in business generally at all. The stock is simply a convenient device for the owners of irrigated land to divide up among themselves the cost, first, of creating, later of maintaining, the facilities for getting the water from the stream to their land.

184) Just by way of clarifying this last question, perhaps a specific instance would be helpful. The Public Utilities Commission of Denver, a municipal feature of the city, one time contracted to buy the stock of the Northern Colorado Irrigation Company, a carrier ditch. There were outstanding a large number of contracts for the sale and attachment of water from the Highline Canal of the Northern Colorado Irrigation Company, for specific pieces of land. But much of the total appropriation of the

ditch had not been sold, so the Public Utilities Commission, on behalf of the city and county of Denver, contracted to buy the outstanding stock of the Northern Colorado Irrigation Company, thereby acquiring all of the unsold water, together with the right to the reversion of any sold water which might fall back into the hands of the company.

Now, there was a real stock transaction where the control of the stock carried the control of the water rights and the ditch, and in the case of a carrier ditch, they hope to levy assessment for enough to make a profit. But, in the case of a mutual ditch, it's non-profit. The assessment can't be large enough for anyone to profit from it.

185) Q. Mr. Saunders, in your opinion, is it possible and proper for a mutual ditch company to buy and hold its own stock, and then sell the water represented by the stock? A. Yes, it is, and that's frequently done. When the stock of a mutual ditch company is sold to the company, it's for the purpose of defraying to that extent, a cost of maintenance and operation not properly assumed by the original stockholder, and if stock is sold for more than that amount, the overplus should be rendered to the original stockholder; but, it usually is not, as a matter of fact, because he's walked off and left it; but the company may thus hold the stock in an endeavor to find a means of bringing about that proportionate sharing of the cost of operation of the ditch which should be borne by all users, so that when one user fails to carry his proper share of a ditch company, it may reach out and try to find somebody else to carry that share so that the burden won't fall on other stockholders. As I say, with respect to a mutual reservoir company, the statute makes no provision for it, and I've never been able to find out a way of getting the job done.

Q. Well, now, assuming that the mutual ditch company owned some of its own stock and wants to have the costs of maintenance borne equally by all the shares of stock, would it be the usual procedure to rent the water represented by the share owned by the company in order to get the money allocable to those shares of stock that's necessary for maintenance purposes? A. No, I wouldn't say as a matter of law that might not be possible, but actually it never is done. What happens, is that the other users just use all the water there is in the ditch in their various proportions and as long as the stock isn't sold to someone who

can apply it to a piece of land, all the water remains in the ditch and is equitably and proportionately distributed among the stockholders who do have land. But, I suppose it would be possible to rent that water, and if that were done, since it's a purely mutual operation, that would to that extent reduce the assessments on other stockholders, because if the ditch company could thus get some money in its treasury, why, it would in that way make it possible to reduce the assessments on the various stockholders.

186) An example of something similar to that is where an original mutual ditch company is enlarged and extended by a new ditch company which, in consideration of going through the right of way of the old ditch company, agrees to perpetually maintain the original ditch, so the original ditch holders have no more assessments to pay. They simply trade personal maintenance for the right of way through their ditch.

Q. Mr. Saunders, do these mutual ditch companies sometimes sell, or I guess the proper term is rent, water to people who are not stockholders? A. No. No. If--as I say, I don't know of a case--don't recall a case of rental of any of this water, but if it were done, it would have to be used under the ditch somewhere. No, actually we just don't do it that way. Now, you know lawyers have such active minds they can think of all kinds of things to do, but the practice here universally is that if there is any stock owned by the mutual ditch company itself, they try to find someone who can put that water to beneficial use and then sell that stock and use the money for the continued operation of the ditch, with the hope that the new buyer will be a provident person who will keep his assessments up so they won't have any more trouble about the share on that particular water.

187) Mr. Garver: No further questions.

Mr. Drexler: I believe I have just one or two on redirect.

Redirect Examination By Mr. Drexler.

Q. Mr. Saunders, assume the case of a mutual irrigation company organized in the 1880's. By the time you get up to 1950 or 1949, would it be difficult, would you think, to analyze its bonded indebtedness through various refinancings to determine what

might represent the original cost of constructing the ditch and what was maintenance that they didn't assess enough to take care of in a particular year, and what was interest that they capitalized and are refinancing, and to define what that indebtedness really went back to? A. Well, I've never seen a mutual ditch company that kept books well enough so that you could really tell what their assessments went for exactly, whether it went for a particular structure or a ditch rider or a new diversion dam, or the like. The books notoriously are rather indifferently kept, and a mutual ditch company for the most part is simply interest in honestly accounting for the cash that comes in, and when it comes to breaking it down as to the niceties that we think of in utility accounting, it just isn't done. I've never encountered a mutual ditch that did that kind of a job of bookkeeping. Most of them just keep a cash book.

Mr. Drexler I believe that is all.

Clerk's Certificate.

194) I, G. Walter Bowman, Clerk of the United States District Court for the District of Colorado, do hereby certify the foregoing pages, numbered one (1) through one hundred ninety-three (193) are the originals, except pages twenty-nine (29) and one hundred ninety-one (191) which are clerk's notes, of the record and proceedings as designated by counsel as required under Paragraph G of Rule 75 of the Rules of Civil Procedure, in a certain case lately in said Court pending, wherein Victor H. Akin and Elsie Akin; Fred C. and Alice M. Kluver; E. F. and Hadye Munroe were plaintiffs and The United States of America was defendant in Civil No. 4710.

In testimony to the above I do hereunto sign my name and affix the seal of said Court, at the City and County of Denver, in said District, this 24th day of October, A. D., 1950.

G. Walter Bowman,
Clerk.

(Seal)

United States v. Victor H. and Elsie Akin, et al.

Filed United States Court of Appeals Tenth Circuit, October 25, 1956.

Robert B. Cartwright,
Clerk.

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1957

No. 722

VICTOR H. AND ELSIE AKIN, FRED C. AND ALICE M. KLUVER, E. F. AND GLADYS MUNROE,

Petitioners,

v.

UNITED STATES OF AMERICA

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT.

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January, 1958

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1957

No.

VICTOR H. AND ELSIE AKIN, FRED C. AND ALICE M. KLUVER, E. F. AND GLADYS MUNROE,

Petitioners,

v.

UNITED STATES OF AMERICA

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT.

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Tenth Circuit in the above cause.

OPINIONS BELOW

The opinion of the District Court (R. 96-102), holding that petitioners are entitled to tax refunds, is not officially reported but is unofficially reported at 56-2 USTC ¶9663. The Findings of Fact, Conclusions of Law and Judgment of the District Court (R. 21-25) are not reported. The opinion of the Court of Appeals, which reversed the District Court, is reported at 248 F. (2d) 742.

These are all set forth in the Appendix to this Petition.

JURISDICTION

The judgment of the Court of Appeals, reversing the judgment of the District Court, was entered October 19, 1957. Jurisdiction of this Court is invoked under 28 U.S.C. § 1254. This Petition is filed within the time prescribed by 28 U.S.C. § 2101(c).

QUESTIONS PRESENTED

1. Where farmers customarily must pay annual assessments to a mutual ditch or irrigation company in order to obtain current supplies of water needed for their farming operations, the first question presented is whether the farmers are to be denied "ordinary and necessary" business expense deductions with respect to portions of the annual assessments they pay.

2. The second question presented is whether the Court of Appeals was justified in overturning and disregarding the amply-supported findings made by the District Court, which held that the full amounts of such annual assessments paid by the farmers were ordinary and necessary business expenses.

STATUTE AND RULE INVOLVED

The statute involved in this case is Section 23(a)(1) of the Internal Revenue Code of 1939. The pertinent portion of such section reads as follows:

"Sec. 23. Deductions From Gross Income.

In computing net income there shall be allowed as deductions:

(a) Expenses—

(1) Trade or Business Expenses—

(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . . . "

The rule involved is Rule 52(a) of the Federal Rules of Civil Procedure, reading in part as follows:

"Rule 52. Findings by the Court.

(a) Effect. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; . . . Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."

STATEMENT OF THE CASE

This case involves a very important and very practical matter for farmers.

It is whether the Internal Revenue Service shall be able to prevent farmers from deducting, as ordinary and necessary business expenses, substantial portions of the annual assessments which the farmers must pay to the mutual ditch or irrigation companies to which they belong. These assessments must be paid regularly by the farmers in order to obtain current supplies of the water which is necessary if their farming operations are to be carried on at all.

Petitioners are farmers in Colorado, operating in a region like many other areas in the United States where farming cannot be carried on without irrigation. A principal method by which such farmers obtain water for irrigation is through membership in mutual irrigation companies, which are non-profit tax-exempt organizations.

They acquire this membership by purchasing shares. However, to continue receiving water each year, the farmers must also pay annual assessments.

Petitioners' primary source of irrigation water was the Water Supply and Storage Company and the North Poudre

Irrigation Company. Petitioners, like their parents in earlier years, were members of these two mutual companies; and they were required to pay annual assessments to these two companies in order to obtain water (R. 12, 22, 33, 34, 62, 63). It was essential that the assessments be paid; in the event that petitioners failed to make full payments, the water needed by them would have been cut off (R. 36, 70). Thus, if there is no payment of the assessment, there is no water for the farmer; and if the farmer has no water, he will have no crops.

In 1948, North Poudre assessed its shareholders $12 per share for water;[1] in 1949 the assessment was $11 per share; and in 1950, the assessment was again fixed at $12. The assessments by Water Supply amounted to $220 per share in each of the years 1949 and 1950. Petitioners paid these assessments and deducted the amounts so paid on their 1949 and 1950 income tax returns as ordinary and necessary expenses of their farming operations (R. 13). In taking such deductions these farmers were following the consistent practice they had followed for many years—a practice never questioned by Internal Revenue until the present dispute arose.

In auditing petitioners' 1949 and 1950 income tax returns, revenue agents took the position that a portion of each assessment must be allocated by petitioners to non-deductible capital expense, and therefore must be disallowed as ordinary and necessary business expenses. The reason given by the revenue agents for such partial disallowance was that the companies had expended some of their funds for the purpose of paying off principal on their bonds and because one of the companies had spent money for a right of way (R. 14-18). Petitioners paid the

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[1] North Poudre's annual assessment for 1948 is involved because petitioner Akin paid a portion of that assessment early in 1949.

amounts of additional taxes and interest attributable to such disallowances, and brought this suit for refund in the District Court for the District of Colorado.

The District Court had before it a stipulation of the parties as to certain matters involved in the case (R. 11-20). Both sides made motions for summary judgment (R. 10-11), which the District Court denied on the ground that there were outstanding unresolved questions of fact (R. 20-21). A trial was then held at which witnesses testified extensively and documentary evidence was received (R. 26-96, 102-119). The testimony made it perfectly clear that unless petitioners had paid the annual assessments in full on a current basis, they would have found themselves in the position of farmers who did not have any irrigation water (R. 36, 60).

At the end of the trial the District Court rendered an oral opinion sustaining petitioners' right to a refund (R. 96-102), in which the Court found, among other things, that (R. 101):

> "The testimony is clear that the assessments made against these farmers by the two companies had to be paid or the farmers wouldn't get any water. They couldn't pay part of the assessment and demand the right to water. They had to pay the whole assessment in order to get their water. If they didn't pay it the water was shut off and their stock would be sold to somebody who was willing to pay for it."

The opinion further found that under all the circumstances "these assessments which have to be paid in order for the farmer to receive the water to grow his crops are ordinary and necessary expenses paid or incurred during the taxable year in carrying out the trade or business of farming" (R. 101). Thereafter the District Court made formal find-

ings of fact and conclusions of law and entered judgment holding petitioners entitled to an aggregate tax refund of $4,799.56, including interest (R. 21-25). Among the District Court's findings of fact, based on the evidence, were Findings 15, 16 and 17, which read as follows (R. 23):

> "15. The assessments made by the companies had to be paid in order for the plaintiffs to obtain water. If the assessments had not been paid, plaintiffs' water would have been shut off and their stock could have been sold. In paying the assessments, the plaintiffs' intention in each case was to assure the delivery of water, if available, and not to make a contribution to the capital of the corporations.
>
> "16. The expenditures by the companies out of the monies obtained from the assessments were made merely to assure the continued availability of water divertible under the water rights held by the companies in trust for the stockholders.
>
> "17. The value of the stock of the companies here involved is in the water rights and the expenditure of new money does not add to the yield of the water rights."

The District Court further found that the annual assessments paid by petitioners to the mutual ditch companies were ordinary and necessary business expenses, deductible in full from gross income (R. 24).

The Government appealed (R. 25-26) and the Court of Appeals for the Tenth Circuit reversed. 248 F. 2d 742. The Court of Appeals held that the Internal Revenue Service had correctly allocated portions of these annual assessments, paid by petitioners, to non-deductible capital expense; and that such allocated portions were not ordinary and necessary business expenses of petitioners. The prin-

cipal ground of decision was that "the intended purpose and resulting effect of the payments made by the taxpayers to the ditch companies for use in the retirement pro tanto of the principal together with the accrued interest thereon was to strengthen the financial position of the ditch companies by reducing their long-term obligations," and that "payments of assessments for such purpose fell within the range of capital contributions." 248 F. 2d at 744.

REASONS FOR GRANTING WRIT

This case involves questions of widespread importance to the farmers of this nation. Many thousands of farmers depend for their water supply upon the mutual irrigation companies in their area. These many thousands of farmers have been required to pay annual assessments in order to get their water. Hence they are confronted with exactly the same question which has been put in issue here.

For some of these individual farmers the actual amount of tax money involved may be relatively small. This magnifies, rather than diminishes, the unfortunate results of the present decision, since it increases the possibility that, if the decision is allowed to stand, the Government will obtain a sizeable and unjustified tax windfall at the expense of the farmers and with perhaps a minimal risk of litigation. Looking at the farming industry of this country as a whole, it is plain that the aggregate impact of this decision is serious as well as exceptionally adverse.

The decision of the Court of Appeals will deprive farmers in many states of the Union of a tax deduction for an item which is, from any realistic standpoint, an essential item of annual expense in their farming operations. Here the Court of Appeals has acquiesced in the Government's highly theoretical approach to something that was intended by the Congress to be—ought surely remain—a very practical

matter. In so doing the Court of Appeals has departed from the principles of common sense which this Court has held to be determinative on the question whether a disbursement meets the statutory test of being an ordinary and necessary business expense. In so doing the Court of Appeals has likewise overturned and disregarded findings of the District Court which are amply supported by the record; such action by the Court of Appeals constitutes a flagrant departure from the principles of limited appellate review which are established both by Rule 52(a) of the Federal Rules of Civil Procedure and by a long line of decisions in this Court.

The importance of the questions presented appears from the record in this case and from other sources of information which are readily available.

The District Judge who heard this case and who presides in an area where irrigation problems are well known commenced his opinion with the following statement (R. 97):

> "This is a case which possibly can have very extensive effects in the 17 Western States that are dependent upon the use of water for the irrigation of crops in order for there to be a productive agriculture. It is impossible for me to see the case in any other light. At the same time I can understand how a lawyer, gazing at the asphalt on Pennsylvania Avenue in Washington, D. C. and concerned only with the printed word of the Federal Tax Laws and the decisions based thereon, in forming the policies of the Internal Revenue Bureau might possibly have a different concept of the situation."

And public records bear out what the District Judge stated as a matter of his own knowledge. In 1950, according to the Census of Agriculture (p. 58), there were 2886

incorporated mutual irrigation or ditch companies supplying water to many thousands of farmers and irrigating 5,639,447 acres.[2] About half of these mutual irrigation or ditch companies are concentrated in the states of Wyoming, Utah, Colorado, Kansas, New Mexico and Oklahoma—which are the states comprising the Tenth Circuit.

The importance of irrigation to agriculture is self-evident. In "Water", the Yearbook of Agriculture for 1955 (U. S. Department of Agriculture), it is stated that 27.5 million acres were irrigated in 1953. The report goes on to say (p. 247):

> "That is only 3.5 per cent of the total land in farms in those states, but its significance to agriculture is much greater than the figures indicates. About 12 per cent of all cropland harvested was irrigated .... The value of crops harvested from irrigated land was 35 per cent of the value of all crops harvested."

Irrigation, it can be seen, is a factor of major importance in our farm economy; and the second largest group of enterprises in the irrigation field are the incorporated mutuals which furnish water to more than 20% of all irrigated lands in the United States. These figures are meaningful since they help to establish the extensive hardship which the Court of Appeals decision will impose upon the farming industry unless the decision is promptly reversed.

Indeed, the vital role played by the mutual ditch or irrigation companies not only is well known, but has been

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[2] The Census of Agriculture does not state the number of farms so supplied with water, but "Irrigation Enterprise Organizations", U. S. Department of Agriculture Circular No. 934, (October, 1953, p. 21), states that the average acreage per farm served by mutuals was 88. This would indicate that more than 60,000 farmers receive their irrigation waters from mutual enterprises.

fully recognized in the opinion of this Court in *Farmers Reservoir & Irrigation Company* v. *McComb*, 337 U. S. 755 (1949). These mutual companies are not like the ordinary corporation. They have grown up and developed methods of operation over a period of years in the many states of the country in which water for irrigation is essential to farming. Although private organizations, the companies are organized as non-profit, tax-exempt corporations and they exist only for the purpose of providing water at cost to their farmer-members.[3] Stock of the two companies here involved is not like ordinary corporate stock. There is no speculation or regular market for such stock and no dividends are paid (R. 35, 99, 107). The only persons interested in owning such stock are farmers through whose lands the irrigation ditches run. Similarly, as the record here shows and as the findings of the District Court establish, petitioners' sole purpose in paying the annual assessments is to assure that the water will continue to be supplied to them (R. 34, 36, 63, 109).

The two mutual ditch companies to which petitioners paid the annual assessments in this case, and many of their counterparts scattered throughout the United States, are small companies and keep records in a simple, informal manner (R. 119). It was not the practice of these companies or of many others to establish reserves for depreciation or replacements—even though reservoirs silted up, ditches frequently required rebuilding, and repairs were not always made promptly (R. 70, 83, 86, 87, 107). Because of this, when maintenance could no longer be deferred, it was sometimes necessary for the companies to borrow money in order to keep the ditches and reservoirs in operation (R. 85, 107, 108). Sometimes when such debt was refinanced, back interest was added to the principal

[3] "Irrigation Enterprise Organizations"—U. S. Department of Agriculture Circular No. 934, pp. 19, 20.

of the debt (R. 71). At other times an emergency would arise because of a break in a ditch or collapse of a structure. On some of such occasions money would be borrowed, but here again, the indebtedness was incurred for repairs (R. 71). Similarly, the acquisition of a new right of way was not for the purpose of extending the activities of the company but merely intended to replace another right of way which could no longer be used (R. 113).

In other words, no matter in what form the money was spent by the mutual ditch companies, it was paid out only to keep the companies' properties in working operation and not to expand or extend them. The ditches, reservoirs and other structures were not added to. They were only repaired when damaged, or replaced when they no longer could be used. Consequently, even from the standpoint of the mutual ditch companies, the annual assessments which the farmer members were required to pay, in order to obtain current deliveries of water, were in fact used only for maintenance and operation and did not result in additions to capital. After all expenditures had been made, the companies had only what existed before (R. 107, 108, 112, 113), and the value of the shares owned by petitioners was not enhanced (R. 23, 24); indeed, the District Court specifically found that the expenditures made by the companies did not create capital (R. 24).

The above is the picture with respect to these two companies, as indeed it would be with respect to other mutual irrigation companies (R. 107, 108, 112, 113, 119). So far as the farmers are concerned it is even simpler. The farmers have only one purpose—to obtain water necessary for irrigation. The payment of the full amount of the annual assessments is an ordinary and necessary expense if they are to be able to operate their farms. Petitioners paid the assessments when levied, since otherwise their water would have been cut off. What petitioners were doing

was to buy water, in the manner customary for the farmers in the area where petitioners carry on their farming operations (R. 36, 48). Their situation is typical of the situation of many thousands of other farmers who must do the same.

What happens in this case, therefore, is not only of importance to the three farmers now petitioning this Court, but to many thousands of farmers who depend upon mutual companies to supply the water needed for their farms. By every test which this Court has prescribed, the full amounts of such annual assessments are ordinary and necessary business expenses to the farmer. This they are if the language of the Internal Revenue Code is "to be read in its natural and common meaning", *Welch* v. *Helvering*, 290 U.S. 111, 114 (1933); or if the word ordinary is to be given "the connotation of normal, usual, or customary", *Deputy* v. *DuPont*, 308 U.S. 488, 495 (1940); or if the words ordinary and necessary "be given their commonly accepted meaning", *Commissioner* v. *Heininger*, 320 U.S. 467, 471 (1943); or if the deduction is to be measured by "the fair and natural meaning" of the Code, cf. *Lykes* v. *United States*, 343 U.S. 118, 120 (1952). The criteria established by these decisions leave no room for the result reached here by the Court of Appeals.[4]

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[4] An additional ground for rejecting the result reached by the Court of Appeals can be found in other types of cases relating to deductions for ordinary and necessary business expenses, where the lower courts have looked behind the labels placed on expenditures in order to arrive at determinations which are in accord with the substance of the entire transaction. This has been particularly so where expenditures, although bearing some semblance in form to capital contributions, in substance were ordinary and necessary expenses made by the taxpayer for the purpose of permitting him to continue to operate his business. *Commissioner* v. *The Hub*, 68 F. 2d 349 (4th Cir., 1934); *Commissioner* v. *Bagley & Sewall Company*, 221 F. 2d 944 (2d Cir., 1955). See also *Teleservice Company of Wyoming Valley*, 27 T.C. 722 (1957), on appeal to Third Circuit; *Tulane Hardwood Lumber Co.*, 24 T.C. 1146 (1955); *Western Wine & Liquor Co.*, 18 T.C. 1090 (1952).

In reaching such an unjust result in this case, it was necessary for the Court of Appeals to override the specific and the general findings which the District Court had made upon a full record (see pages 5-7, above). For example, the District Court found, on the evidence, that it was petitioners' intention, in paying the assessments, to assure delivery of water and "not to make a contribution to the capital" of the mutual ditch companies. Yet the Court of Appeals took it upon itself to reverse on the ground that "the intended purpose" of petitioners "was to strengthen the financial position." Upon the detailed circumstances shown by the record, the District Court found that the full amount of the assessments paid by petitioners were ordinary and necessary business expenses; yet the Court of Appeals held the contrary with respect to the allocated portions actually in issue in the litigation.

What the Court of Appeals has done in overturning these findings not only works to the great detriment of the farming community of this Nation, but it is also in direct conflict with Rule 52(a) of the Federal Rules of Civil Procedure and with applicable decisions of this Court. Rule 52(a) provides, with respect to all actions tried upon the facts without a jury, that "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses". Moreover, this Court specifically held in *Commissioner* v. *Heininger*, 320 U.S. 467, 475 (1943), that "Whether an expenditure is directly related to a business and whether it is ordinary and necessary are doubtless pure questions of fact in most instances". This principle is firmly accepted in most circuits.[5] The

[5] *Revere Racing Association* v. *Scanlon*, 232 F. 2d 816, 818 (1st Cir. 1956); *Commissioner* v. *Bagley & Sewall Co.*, 221 F. 2d 944, 946 (2nd Cir., 1955); *Chester Distributing Co.* v. *Commissioner*, 184 F. 2d 514, 515 (3rd Cir. 1950); *Nowland* v. *Commissioner*, 244 F. 2d 450, 454 (4th Cir.,

present decision establishes that the Court of Appeals for the Tenth Circuit now constitutes a notable exception. The Tenth Circuit's plain disregard of this well-settled principle calls for the exercise of this Court's supervisory jurisdiction.

CONCLUSION

This Court has emphasized that "Taxation is an intensely practical matter and laws in respect of it should be construed and applied with a view of avoiding, so far as possible, unjust and oppressive consequences." *Farmers Loan & Trust Co.* v. *State of Minnesota*, 280 U.S. 204, 212 (1929). Farming and the expenses payable in connection therewith are also practical matters, and the taxes payable by farmers should be levied accordingly. As this Court has said in connection with other legislation affecting farmers, the courts have a duty to see that the benefits of legislation are not "frittered away by narrow formalistic interpretations which disregard the spirit and the letter of the Act". *Wright* v. *Union Central Life Ins. Co.*, 311 U.S. 273, 279 (1941); *Wright* v. *Logan*, 315 U.S. 139, 141-142 (1942).

The practical situation—as the District Court which tried the facts in this case found—was that annual assessments were paid to obtain water and that this was an ordinary and necessary expense of conducting the business of farming. Since "it is for the trial court, upon consideration of an entire transaction, to determine the factual category in which a particular transaction belongs," *United States* v. *Cumberland Public Service Co.*, 338 U.S. 451, 456 (1950), the appellate courts should accept the determination so

1957); *Limerick, Inc.* v. *Commissioner*, 165 F. 2d 483, 484 (5th Cir., 1948); *United States* v. *E. L. Bruce Co.*, 180 F. 2d 846, 847 (6th Cir. 1950); *Clinton Co.* v. *Commissioner*, 159 F. 2d 102, 104 (7th Cir., 1946); *Byers* v. *Commissioner*, 199 F. 2d 273, 276 (8th Cir., 1952); *United States* v. *Star-Kist Foods*, 240 F. 2d 759, 762 (9th Cir., 1956).

made. The farming community of the Nation should be promptly relieved of the unjust burden imposed on it by the decision of the Court of Appeals.

For the foregoing reasons the petition for certiorari should be granted.

Respectfully submitted,

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January, 1958

APPENDIX

OPINION OF DISTRICT COURT, AFTER TRIAL

The Court [Breitenstein, D.J.]: Well, I think I might as well decide this at this time. You are going to have to bear with me a little because I haven't had too much of an opportunity to consolidate my thoughts the last few weeks.

In this case the plaintiffs are suing for a refund of income tax paid to the United States. The situation arises from the fact that the plaintiffs are farmers who received their water from certain mutual ditch companies. The two companies involved are Water Supply and Storage Company and the North Poudre Irrigation Company. These are corporations not for profit, organized under Colorado law. They distribute water to the farmers who use the water for the growing of agricultural crops. In the years in question the annual assessments made by each company included items which the Government contends amount to contributions to capital assets and are in excess of the amount reasonably and properly required for repairs and maintenance and operation, and as to such portions of the assessments that are in excess of the requirements for maintenance and operation the Government contends that the farmer is not entitled to deduct such amounts as ordinary and necessary expenses paid or incurred during the taxable years in question.

This is a case which possibly can have very extensive effects in the 17 Western States that are dependent upon the use of water for the irrigation of crops in order for there to be a productive agriculture. It is impossible for me to see the case in any other light. At the same time I can understand how a lawyer, gazing at the asphalt on Pennsylvania Avenue in Washington, D. C. and concerned only with the printed word of the Federal Tax Laws and the decisions based thereon, in forming the policies of the Internal Revenue Bureau might possibly have a different concept of the situation.

The use of these mutual ditch companies is not confined to the State of Colorado. It is common in the Western

States. The Supreme Court of Colorado in the case of Coffin v. The Left Hand Ditch Company, 6 Colorado, page 443, had some discussion of the situation which confronted the Colorado settlers. It said this:

"The climate is dry, and the soil, when moistened only by the usual rainfall, is arid and unproductive; except in a few favored sections, artificial irrigation for agriculture is an absolute necessity. Water in the various streams thus acquires a value unknown in moister climates. Instead of being a mere incident to the soil, it rises, when appropriated, to the dignity of a distinct usufructuary estate, or right of property. It has always been the policy of the national, as well as the territorial and state governments, to encourage the diversion and use of water in this country for agriculture; and vast expenditures of time and money have been made in reclaiming and fertilizing by irrigation portions of our unproductive territory. Houses have been built, and permanent improvements made; the soil has been cultivated, and thousands of acres have been rendered immensely valuable, with the understanding that appropriations of water would be protected. Deny the doctrine of priority or superiority of right by priority of appropriation, and a great part of the value of all this property is at once destroyed."

The Court goes on to say, on the same page:

"* * * we think it is, and has always been, the duty of the national and state governments to protect (this right). The right itself, and the obligation to protect it, existed prior to legislation on the subject of irrigation."

And I might add parenthetically it existed prior to legislation on the subject of income tax liability.

The Supreme Court of the United States has recognized the same thing. Among other cases wherein it has been recognized is the decision in Clark v. Nash, 198 U.S. 361. There in talking about the difference between the East and the West the Court says, on page 370:

"The rights of a riparian owner in and to the use of the water flowing by his land are not the same in the arid and

mountainous States of the West that they are in the States of the East. These rights have been altered by many of the Western States, by their constitutions and laws, because of the totally different circumstances in which their inhabitants are placed, from those that exist in the States of the East, and such alterations have been made for the very purpose of thereby contributing to the growth and prosperity of those States arising from mining and the cultivation of an otherwise valueless soil, by means of irrigation. This court must recognize the difference of climate and soil, which render necessary these different laws in the States so situated."

Now, I recognize those are general statements. To me they have some pertinence here.

The first Colorado Supreme Court case that discusses the status of these companies seems to be Kendrick v. Twin Lakes Reservior Company, 58 Colorado 281. Prior to that case there were innumerable decisions that need not be mentioned, which pointed out consistently, time after time, that in a ditch company or a reservoir company the water rights are not owned by the company but are owned by those who put the water to beneficial use. That is elementary Hornbook law in Colorado. In the Kendrick case, which involved a mutual reservoir Company, the Court on page 282 says:

"The corporation is purely a mutual reservoir company, in which the capital stock stands for and represents the consumer's interest in the reservoir, canal and water rights. The benefit derived from owning the stock, is the exclusive use of the water it represents. It is not a dividend corporation, a dividend has never been declared, and under its charter, never can be declared on its capital stock."

That decision was in 1914. As I recall, that is the year after the income tax amendment to the Federal Constitution was adopted. The Court said then that one of these companies was not a dividend corporation.

There are a number of other cases. One which is of some interest because it was decided by my colleague, Judge William Lee Knous, when he was on the Supreme Court of Colorado, is Beaty v. Commissioners, 101 Colorado 346. Reading from page 351, this is the same quotation Mr. Swanson read this morning, Judge Knous said this:

"It definitely appears that this mutual canal company was organized for the convenience of its members in the distribution to them of their water for use upon their lands in proportion to their respective interests. Under these circumstances the stock certificates of the canal company, in the form in which they were issued and held by the plaintiff, were merely the muniments of title to her water right, which water right, the thing of value owned by her, unquestionably was real estate and not corporate stock."

Judge Knous refers to some other decisions where the same holding is made.

The last case that I know of is also one which Mr. Swanson mentioned this morning, Billings v. Industrial Commission, which involved a question of whether or not an injury received by an employee of a mutual ditch company was compensable. The Court in discussing the character of these companies says this:

"Under the undisputed facts of this case the conclusion is inescapable that the Billings Ditch is a mutual irrigation ditch, and that the corporation is merely the vehicle by which its owners operate and manage its affairs. It was neither organized, nor is it operated, for profit, but solely for the convenience of its members in the management of their irrigation system and the distribution of the proper apportionment of water to the owners as their respective interests may appear; the shares of stock being merely incidential to the ownership of the water rights." Then it cites a number of cases.

"The shares of stock," says the Court, "in the Billings Ditch Company are not personal property, but represent

varying interests in separate parcels of real estate. The opinion cites some more cases and goes on:

"What it does, and the practice and policy adopted by a corporation in its operation, rather than the language contained in its articles of incorporation, are determinative of its character."

So we have here a couple of mutual ditch companies, corporations not for profit, that serve as the facilities through which the farmers get the water which they have to have to irrigate their lands to raise crops. Now, it is true that these companies have constructed works, reservoirs, canal systems, diversion works and things like that. But as said in the 58 Colorado case, those are of value only as they permit the diversion and use of water through them, and separate and apart from that they have no value. It is a matter of common knowledge that here on the Eastern Slope of Colorado the streams have been over-appropriated for many, many years. In fact, in recent years 1870 rights on the South Platte yielded very little water. That being true, it seems to me that it is apparent, I think the evidence in this case justifies the conclusion, that these expenditures which are made by these companies are merely to continue the assured availability and continued availability of the water divertible under the rights which are owned and used by the shareholders in the company. They do not create capital in the true sense of the word. The value is in the water rights and the rights to divert the water are old, old rights. The expenditure of this new money does not add one iota to the yield of any of those water rights, doesn't get any more water from them. All it does is to facilitate, expedite or assist, whatever you want to call it, in the diversion and distribution of the water which is covered by these old rights.

So you have a situation where the Government, in effect, claims that part of the charge which the farmer pays is not a proper business expense because it goes to a capital item, the retirement of bonded debt, the purchase of a dragline, the purchase of a truck, the building of a new diversion structure, or the purchase of a right of way that may be necessary in order to add to the usefulness of a

ditch. None of those things have any real value separate and apart from the water because if it wasn't for the water they would not be needed. They only assist in getting the water from the streams, the lakes, to the soil where it grows crops.

The testimony is clear that the assessments made against these farmers by the two companies had to be paid or the farmers wouldn't get any water. They couldn't pay part of the assessment and demand the right to water. They had to pay the whole assessment in order to get their water. If they didn't pay it the water was shut off and their stock would be sold to somebody who was willing to pay for it. We are not concerned here with a case of the taxability of a capital gain on the sale of a farm. We are not concerned with the taxability of income to one of these companies. We are not concerned with a possible tax on the proceeds from a liquidation of a company and distribution of its assets among those entitled thereto. We are just concerned with the question of whether or not a farmer is entitled to deduct as an ordinary and necessary business expense the sum of money he had to pay in order to get water for the ensuing year.

The Supreme Court of the United States and the Supreme Court of Colorado has recognized the absolute necessity of the use of water in semi-arid regions, such as we have here, for irrigation. The Supreme Court of Colorado has recognized the status of these companies as being that of facilities which are organized to get the water to the farmers. The Supreme Court of Colorado has said that the stock certificates represent only the right of the farmer to receive water, that they are not personal property but real property.

Under all the circumstances, it seems to me that these assessments which have to be paid in order for the farmer to receive the water to grow his crops are ordinary and necessary expenses paid or incurred during the taxable year in carrying out the trade or business of farming. That being so, under the applicable section of the income tax laws they are deductible. Accordingly, judgment will be entered in favor of the taxpayers and against the Government.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND JUDGMENT OF DISTRICT COURT

This matter coming on to be heard on the 22nd day of June, 1956, the plaintiffs being represented by Stanley L. Drexler, Esq., and Ellis J. Sobol, Esq., and the defendant being represented by Robert Swanson, Esq., Assistant U. S. Attorney for the District of Colorado, and the Court having considered the testimony of the witnesses, read the pleadings, examined the evidence introduced, having heard the statements of counsel and being fully advised in the premises, the Court doth find as follows:

1. The facts stipulated by the parties are so found.

2. This is an action for refund of income taxes paid by plaintiffs to the United States.

3. The plaintiffs, Victor H. and Elsie Akin, Fred C. and Alice M. Kluver and E. F. and Gladys Munroe were husband and wife during all times relevant herein.

4. The plaintiffs each filed timely joint individual federal income tax returns for the taxable years ended December 31, 1949, and December 31, 1950, with the Collector of Internal Revenue for the District of Colorado and paid to the said Collector the taxes shown to be due thereon.

5. During the said taxable years the plaintiffs each were engaged in the business of farming.

6. During the said taxable years, Victor H. Akin and Elsie Akin, Fred C. and Alice M. Kluver and E. F. Munroe were stockholders in and obtained water for irrigation of their farms from the North Poudre Irrigation Company. During said taxable years Victor H. Akin, Fred C. and Alice M. Kluver were stockholders in and obtained water for irrigation of their farms from The Water Supply and Storage Company.

7. The North Poudre Irrigation Company and The Water Supply and Storage Company are both corporations not for profit, organized under Colorado law. They distribute water to farmers who use the water for the growing of agricultural crops.

8. During each of the years involved each of the companies levied annual assessments on their stockholders.

The plaintiffs herein paid the assessments so levied and deducted the amounts paid on their federal income tax returns as ordinary and necessary business expenses of farming.

9. The Commissioner of Internal Revenue disallowed that portion of the assessments so paid and deducted which was allocated or spent by the companies for expenditures of a capital nature and debt retirement and assessed deficiencies in income tax against the plaintiffs.

10. The plaintiffs paid the assessed deficiencies on November 4, 1952, to the Collector of Internal Revenue for the District of Colorado, the following amounts paid being attributable to the disallowance of the deduction of a portion of the assessments paid:

	1949	Assessed Interest	1950	Assessed Interest
Akins	$ 606.72	$ 96.13	$.....	$.....
Kluvers	1,135.90	164.25	1,135.90	154.56
Munroes	182.14	2.93	237.38	23.97

11. For the taxable year 1950 the Commissioner of Internal Revenue allowed the Akins a refund in the amount of $613.72 arising out of adjustments not here involved and conceded by defendant to be correct, instead of the amount of $1,190.63, by which the Akins alleged they overpaid their tax for the year. The amount overpaid attributable to the aforesaid disallowance of deduction of a portion of the assessment paid to the said companies is $576.91.

12. On May 12, 1953, the plaintiffs filed with the Director of Internal Revenue for the District of Colorado claims for refund for each of the said amounts for each of the years as set forth above.

13. More than six months elapsed from the time plaintiffs filed their claims for refund until the time of filing of this suit.

14. The plaintiffs used substantially all the water obtained from the companies in their business of farming. (In one year involved, Mr. Kluver rented a small amount of water to a neighbor as an accommodation.)

15. The assessments made by the companies had to be paid in order for the plaintiffs to obtain water. If the

assessments had not been paid, plaintiffs' water would have been shut off and their stock could have been sold. In paying the assessments, the plaintiff's intention in each case was to assure the delivery of water, if available, and not to make a contribution to the capital of the corporations.

16. The expenditures by the companies out of the monies obtained from the assessments were made merely to assure the continued availability of water divertible under the water rights held by the companies in trust for the stockholders.

17. The value of the stock of the companies here involved is in the water rights and the expenditure of new money does not add to the yield of the water rights.

18. It is common knowledge that on the Eastern Slope of Colorado the streams have been over-appropriated for many, many years and that there has not been enough water to satisfy agricultural needs.

Conclusions of Law

The Court has jurisdiction of the parties and of the subject matter of this action

19. Under Colorado law, a water right, i.e., the right to divert water from a natural stream and put it to beneficial use, is owned by he who actually puts the water to beneficial use and is not owned by the ditch or reservoir companies which are devices for getting the water to the users.

20. Under Colorado law, a water right is a distinct usufructuary estate, or a right in property.

21. Under Colorado law, non-user of a water right results in an abandonment of such right.

22. Under Colorado law, the stock certificates of a mutual ditch, irrigation or reservoir company such as the companies here involved represent only the right to receive water and they are not personal property but real property.

23. The expenditures made by the companies here involved did not create capital within the meaning of the 1939 Internal Revenue Code.

24. Amounts paid by plaintiffs, farmers, pursuant to stock assessments by Colorado mutual ditch and irrigation companies, not for profit, the payment of such assessments to the companies being a condition precedent to the right to receive water for irrigation of their farms, and the water so obtained being used for the irrigation of their farms, constituted ordinary and necessary expenses paid or incurred during the taxable year in carrying on their farming business within Sec. 23(a) (1) 1939 Internal Revenue Code and hence were deductible in full from gross income.

25. The income taxes and interest here involved were illegally and erroneously collected by the United States.

Accordingly, it is adjudged and decreed that the plaintiffs are entitled to receive refunds of taxes and interest and that the defendant shall pay such refunds in the following amounts:

1949

	Tax Overpayment	Interest Overpayment	Total Refund
Akins	$ 606.72	$ 96.13	$ 702.85
Kluvers	1,135.90	164.25	1,300.15
Munroes	182.14	2.93	185.07

1950

	Tax Overpayment	Interest Overpayment	Total Refund
Akins	$ 576.92	$	$ 576.92
Kluvers	1,619.26	154.56	1,773.82
Munroes	237.38	23.37	260.75

	1949 and 1950 Total Refund
Akins	$1,279.77
Kluvers	3,073.97
Munroes	445.82

Plus interest in each case as provided by law.

Done this 22nd day of June, 1956, in open court.

JEAN S. BREITENSTEIN,
Judge,
United States District Court,
for the District of Colorado.

Entered on the docket, June 22, 1956, G. Walter Bowman, Clerk.

OPINION OF THE COURT OF APPEALS
(October 19, 1957)

Before BRATTON, Chief Judge, and HUXMAN and MURRAH, Circuit Judges.

BRATTON, Chief Judge.

The question presented for determination is whether portions of annual assessments paid by taxpayers who were farmers to two mutual ditch companies which supplied water for the irrigating of the farms of the taxpayers and were used by such companies to retire long term indebtedness and to purchase a right of way were deductible from gross income of the taxpayers as ordinary and necessary expenses incurred in carrying on their farming businesses.

The taxpayers were engaged in the business of farming in Colorado, and they obtained water for the irrigating of their farm lands from two mutual ditch companies. The ditch companies were corporations organized under the laws of Colorado, and they distributed water to farmers who used it for the growing of agricultural crops. In order for a water right owner to be entitled to receive water distributed by the companies, it was necessary that he have stock in the company with all assessments paid. If a stockholder defaulted in the payment of an assessment, interest was charged; and if he remained in default after notice and demand for payment, his stock could be sold at public auction. During the years 1949 and 1950, each company made an assessment pro rata upon all of its stock issued and outstanding. Each assessment of one company contained an item for the retirement pro tanto of a long term indebtedness, an item for the payment of interest on the outstanding indebtedness, and an item for the purchase of a right of way; and each assessment of the other company contained an item for the retirement in part of a long term indebtedness, and an item for the payment of interest on such indebtedness. The taxpayers paid the respective annual assessments levied upon them by one or both of the companies and deducted the amounts thereof from their

gross income as ordinary and necessary business expenses incurred in the operation of their farming businesses. The Commissioner of Internal Revenue disallowed the portions of the deductions attributable to the items referred to. Resulting deficiencies in tax were paid; claims for refund were made and disallowed; this suit was filed to recover the amounts of the deficiencies; judgment was rendered for the taxpayers; and the appeal was seasonably taken from the judgment.

Deductions from gross income are not a matter of right. Neither do they turn upon equitable considerations. They are a matter of legislative grace. And a taxpayer asserting a deduction, must bring himself squarely within the terms of a statute expressly authorizing it. New Colonial Ice Co. v. Helvering, 292 U.S. 435; White v. United States, 305 U.S. 281; Deputy v. DuPont, 308 U.S. 488; Hales-Mullaly, Inc. v. Commissioner, 131 F. 2d 509; F. A. Gillespie & Sons Co. v. Commissioner, 154 F. 2d 913, certiorari denied 329 U.S. 781; Chicago Mines Company v. Commissioner, 164 F. 2d 785, certiorari denied 333 U.S. 881.

Section 23(a)(1)(A) of the Internal Revenue Code of 1939 authorizes a deduction from gross income of all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. But the statute is limited to ordinary and necessary expenses paid or incurred in the conduct of a trade or business and does not authorize a deduction for capital expenditures. Welch v. Helvering, 290 U. S. 111; Hales-Mullaly v. Commissioner, supra. It is not always easy to find a verbal formula which readily supplies an unerring guide in drawing the boundary line between current expenses and capital outlays. But it may be said in general terms that an expenditure should be treated as one in the nature of a capital outlay if it brings about the acquisition of an asset having a period of useful life in excess of one year or if it secures a like advantage to the taxpayer which has a life of more than one year. Hotel Kingkade v. Commissioner, 180 F. 2d 310.

The parties discuss the relationship existing between the ditch companies and the taxpayers as throwing light

upon the decisive question whether the sums which the taxpayers paid to the ditch companies for use in retiring in part the outstanding indebtedness of the ditch companies, and for use in acquiring the right of way, constituted ordinary and necessary expenses incurred by the taxpayers in the conducting of their farming businesses. The status of property in respect to the rights and interests of parties therein is created and determined by state law, but the manner in which and the extent to which parties are liable for federal taxes must be determined by federal revenue legislation. Morgan v. Commissioner, 309 U.S. 78; Helvering v. Stuart, 317 U.S. 154; Broderick v. Gore, 224 F. 2d 822; Broderick v. Moore, 226 F. 2d 105; Smith v. United States, 230 F. 2d 470; In re Sweet's Estate, 234 F. 2d 401, certiorari denied, 352 U.S. 878.

As we understand the law of Colorado, the two mutual ditch companies organized in that state are nonprofit corporations; each owns the naked legal title to its ditches and related facilities used in the distribution of water to its members, including the taxpayers, for use upon their lands but the owners of the farms served in that manner are the equitable and actual owners of such ditches and related facilities in proportion to their respective interests; the stock certificates issued by the companies to their members are merely muniments of title to their water rights; and the value of the stock is in the water rights which it represents. Kendrick v. Twin Lakes Reservoir Co., 58 Colo. 281, 144 Pac. 884; Beaty v. Board of County Commissioners of Otero County, 101 Colo. 346, 73 Pac. 2d 982; Billings Ditch Co. v. Industrial Commission, 127 Colo. 69, 253 Pac. 2d 1058. But in each instance here, the ditch company was the only one liable upon the outstanding indebtedness for the retirement of which a portion of the amounts paid by the taxpayers to the ditch company was to be used. The taxpayers were not personally liable for any portion of the indebtedness. And the intended purpose and resulting effect of the payments made by the taxpayers to the ditch companies for use in the retirement pro tanto of the principal together with the accrued interest thereon was to strengthen the financial position of the ditch companies by reducing their

long-term obligations. In respect to federal revenue legislation, the payments of assessments for such purpose fell within the range of capital contributions to the ditch companies, respectively, rather than ordinary and necessary expenses incurred in carrying on the businesses of the taxpayers. Compare, 50 East 75th Street Corp. v. Commissioner, 78 F. 2d 158. The legal title to the right of way acquired with the proceeds of the assessments for that purpose was taken in the name of the ditch company. And the purpose in acquiring and taking legal title to the right of way was to expand the distribution system by creating an addition to it. Again, the payments of the assessments for that purpose constituted capital contributions, not ordinary and necessary expenses incurred by the taxpayers in carrying on their businesses. Compare, Cripple Creek Coal Co. v. Commissioner, 63 F. 2d 829.

The judgment is reversed and the cause is remanded.

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No. 722

In the Supreme Court of the United States

OCTOBER TERM, 1957

VICTOR H. AND ELSIE AKIN, FRED C. AND ALICE M. KLUVER, E. F. AND GLADYS MUNROE, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINIONS BELOW

The findings of fact, conclusions of law and opinion of the District Court (Pet. A–1–10) are not reported. The opinion of the Court of Appeals (Pet. A–11–14) is reported at 248 F. 2d 742.

JURISDICTION

The judgment of the Court of Appeals was entered on October 19, 1957. (Pet. A–14; Supp. R. 10.)[1]

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[1] References designated "R." are to the transcript of record filed in the Court of Appeals. References designated "Supp. R." are to the supplementary typewritten transcript of record filed in this Court.

The petition for a writ of certiorari was filed on January 14, 1958. The jurisdiction of this court is invoked under 28 U. S. C., Section 1254 (1).

QUESTION PRESENTED

Whether portions of annual assessments paid by taxpayers in 1949 and 1950 to two mutual ditch companies and used by such companies to retire long-term indebtedness and for the purchase of a right of way were, as taxpayers claim, deductible from their gross income as ordinary and necessary business expenses, or whether, as held by the Commissioner, they were non-deductible capital contributions.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Sec. 121, Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of prop-

erty to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(26 U. S. C. 1952 ed., Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

* * * * *

(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

* * * * *

(26 U. S. C. 1952 ed., Sec. 24.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.22 (a)-16. *Contributions to Corporation by Shareholders.*—

If a corporation requires additional funds for conducting its business and obtains such needed money through voluntary pro rata payments by its shareholders, the amounts so received being credited to its surplus account or to a special capital account, such amounts will not be considered income, although there is no increase in the outstanding shares of stock of the corporation. The payments under such circumstances are in the nature of voluntary assessments upon, and represent an additional price paid for, the shares of stock held by the individual shareholders, and will be treated as an addition to and as a part of the operating capital of the company. * * *

STATEMENT

The facts, as stipulated by the parties (R. 11–20) and as found by the District Court (R. 21–23), may be summarized as follows:

Taxpayers are engaged in the business of farming in Colorado, and obtain their water for irrigation purposes through two mutual ditch companies of which they are stockholders. These companies, the Water Supply and Storage Company and the North Poudre Irrigation Company, were incorporated in Colorado in 1891 and 1901, respectively, for the purpose of acquiring and maintaining land, water rights and appropriations, acquiring or constructing and maintaining reservoirs, ditches and necessary structures, and distributing water to stockholders owning land under their ditches in Larimer and Weld Counties. Both companies had the right under their charters to borrow money, to secure loans, and to procure funds on the company property or franchises. In order for a water-right owner to be entitled to receive water distributed by the companies, he was required to have stock in the company with all assessments paid. If a stockholder became in default, interest was charged from the date due until payment. If he remained in default 30 days after notice and demand for payment of an assessment, his stock could be sold at public auction. (R. 12, Stip. Exs. P–1 and Q–2.)

In 1949 and 1950, the Water Supply and Storage Company had 286 and 285 stockholders respectively, and its capital stock consisted of $60,000 or 600 shares of $100 par value. Mr. Akin owned 2½ shares of

stock and the Kluvers 14 shares. (Stip. Ex. R–3.)

In 1949 and 1950, the North Poudre Irrigation Company had 332 and 331 stockholders respectively, and its capital stock consisted of $500,000 or 10,000 shares with a par value of $50. The Akins owned 365 shares, the Kluvers owned 417 shares in 1949 and 317 shares in 1950, and Mr. Munroe owned 107 shares. (Stip. Ex. S–4.)

During each of the taxable years 1949 and 1950, the companies levied annual assessments on their stockholders. Taxpayers paid their assessments and deducted the amounts paid as ordinary and necessary business expenses in their income tax returns. (R. 13.)

The Commissioner disallowed a portion of the deductions taken by taxpayers on the ground that such portions did not constitute ordinary and necessary expenses of carrying on their farming operations, but represented amounts allocated or spent by the two companies for items of a capital nature, as follows (R. 13–18):

In 1948, $3.05 of the $12 per share North Poudre assessment was allocated to the retirement of $30,500 of the principal of a long-term mortgage debt. One-half of the $3.05 was paid in 1949 and disallowed as a deduction in that year.

In 1949, $4.45 of the $11 per share North Poudre assessment was disallowed since $3.17 per share was allocated to the payment of $31,700 of the principal of a mortgage note, and $1.28 per share for the purchase at $12,800 of a right of way for the Colorado Big Thompson Ditch.

In 1950, $4.60 of the $12 per share North Poudre assessment was disallowed since $3.30 was allocated to the payment of $33,000 of the principal of a mortgage note, and $1.30 for the purchase at $13,000 of a right of way for the Colorado Big Thompson Ditch.

In 1949, $71.66-2/3 of the $220 per share Water Supply Company assessment and in 1950 $73.33-1/3 of the $220 assessment were disallowed since both amounts were applied toward the retirement of the principal of a long-term mortgage note to the extent of $43,000 and $44,000 respectively.

The following deficiencies in tax were attributable to the disallowance of the portion of the assessments referred to (R. 22, 23):

	Deficiency	Interest
1949		
Akins	$606.72	$96.13
Kluvers	1,135.90	164.25
Munroes	182.14	2.93
1950		
Akins	576.91	
Kluvers	1,135.90	154.56
Munroes	237.38	23.97
	3,874.95	441.84

The District Court held that taxpayers correctly deducted the disallowed amounts of the assessments and that they were entitled to the refunds claimed. (R. 24–25.) The Court of Appeals reversed, holding that the amounts disallowed by the Commissioner represented capital contributions to the two companies, rather than ordinary and necessary expenses incurred in carrying on the business of the taxpayers. (Pet. A–1–14.)

ARGUMENT

The decision of the court below is clearly correct. As taxpayers recognize, outlays which constitute capital contributions are not deductible as "ordinary and necessary expenses" in carrying on a trade or business under Section 23 (a) (1) (A) of the Internal Revenue Code of 1939. See 1939 Code Section 24 (a) (2); *Welch* v. *Helvering,* 290 U. S. 111, 115. In drawing the line between a business expense and a capital expenditure, the nature of the obligation out of which the payment arose must be considered. Moreover, the claimed deduction must be examined in the light of the familiar rule that an income tax deduction is a matter of legislative grace, and that the burden of clearly showing the right thereto is on the taxpayer. *Interstate Transit Lines* v. *Commissioner,* 319 U. S. 590, rehearing denied, 320 U. S. 809. See also *Deputy* v. *du Pont,* 308 U. S. 488; *Welch* v. *Helvering, supra.*

In general, an expenditure should be treated as capital outlay if it is for the acquisition of an asset having a useful life in excess of one year. *Hotel Kingkade* v. *Commissioner,* 180 F. 2d 310 (C. A. 10th). Expenditures for a right of way and for the retirement of long-term indebtedness clearly fall within that category. Money spent or allocated for a right of way is a capital expenditure, for it is designed to expand the particular system and create additions to it. *Haller* v. *Commissioner,* 14 B. T. A. 488, petition for review dismissed November 21, 1932

(C. A. D. C.); see, also, *Cripple Creek Coal Co.* v. *Commissioner,* 63 F. 2d 829 (C. A. 7th); *Atlantic Coast Line Railroad Co.* v. *Commissioner,* 31 B. T. A. 730, affirmed, 81 F. 2d 309 (C. A. 4th), certiorari denied, 298 U. S. 656; *Caflisch Lumber Co.* v. *Commissioner,* 20 B. T. A. 1223. Likewise, an amount paid to retire the principal of long-term indebtedness is not a current business expense, but a capital expenditure. *King Amusement Co.* v. *Commissioner,* 44 F. 2d 709 (C. A. 6th), certiorari denied, 282 U. S. 900; *Newark Milk & Cream Co.* v. *Commissioner,* 34 F. 2d 854 (C. A. 3d). As the court below held (Pet. A–13–14), the effect of the payments used in the retirement of the long-term indebtedness of the mutual irrigation companies was to strengthen their financial position by reducing their long-term obligations. This is fully supported by the record which shows that the bonded indebtedness of the companies is or soon will be non-existent, and that the shareholders will thus receive the tangible benefit of reduced assessments as a result of their prior contributions to capital. (See audit reports, Stip. Exs. AA–12, BB–13, Government Exs. 1, 2.)

The disallowed portions of the assessments, i. e., the portions applied by the mutual irrigation companies to the retirement of the principal of long-term indebtedness and for the purchase of a right of way, were stipulated to have been "expenditures of a capital nature" (R. 14–15), and the District Court so found (R. 22, par. 9). In view of this stipulation and finding of fact, the Court of Appeals most certainly did not

violate the "clearly erroneous" rule (Rule 52 (a)) when it reversed the District Court for failing to hold as a matter of law that taxpayers were not entitled to deduct these amounts as current business expenses.

Taxpayers emphasize the peculiarities of water problems in Colorado, contending that, since they are obligated to pay the assessments before they can receive any water, the entire amount of the assessment is an ordinary and necessary expense of conducting farming operations. (Pet. 10–12.) This Court's decision in *Farmers Irrigation Co.* v. *McComb*, 337 U. S. 755, refutes the notion that an assessment by a mutual irrigation company is an annual payment for water as such. The stockholders of a mutual irrigation company have an undivided right in the physical assets of the company, and assessments (as do the disallowed portions here involved) may result in a strengthening of the stockholders' financial position in such assets. The fact that taxpayers under Colorado law (2 Colorado Revised Statutes (1953), Section 31–14–4) and by agreement (Stip. Exs. P–1, Q–2) may not receive delivery of any water until all assessments shall have been paid obviously does not mean that the entire amount of the annual assessments represents the annual price of the water, or current business expenses. The contention that the payments should be deductible because they are *necessary* in order to obtain water overlooks the fact that the element of necessity alone does not determine the deductibility of an expenditure. The fact that a taxpayer may be compelled by necessity to make capital improvements and expenditures does not mean that these are deductible business

expenses. *Mt. Morris Drive-In Th. Co.* v. *Commissioner,* 238 F. 2d 85 (C. A. 6th), affirming 25 T. C. 272; *Cripple Creek Coal Co.* v. *Commissioner,* 63 F. 2d 829 (C. A. 7th). Moreover, the "mere fact that the expense was incurred under contractual obligation does not of course make it the equivalent of a rightful deduction under Section 23 (a)." *Interstate Transit Lines* v. *Commissioner,* 319 U. S. 590, 594.

Contrary, therefore, to taxpayers' contention (Pet. 10–11), the disallowed portions of the assessments—those relating to the retirement of long-term debt and the purchase of a right of way—were not the ordinary costs of operation and maintenance. The portions of the assessments which were used to defray ordinary expenses of operation and maintenance, such as those incurred for ditch cleaning, weed cutting, and the like, were allowed as deductions.

There is no showing in the record to support taxpayers' contention (Pet. 7, 14) that a denial of the claimed deductions would result in unjust or oppressive consequences. In accordance with Treasury Regulations 111, Section 29.22 (a)–16, *supra;* p. 3, the proper way to treat the disallowed portions of the assessments is to add such amounts as an additional cost of taxpayers' stock in the mutual irrigation companies. In any event, the allowance of deductions does not turn upon equitable principles. *Interstate Transit Lines* v. *Commissioner, supra; Deputy* v. *du Pont, supra; White* v. *United States,* 305 U. S. 281; *New Colonial Co.* v. *Helvering,* 292 U. S. 435.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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